Enhancing Financial Innovation & Access

Review of government interventions that promote access to credit for Micro, Small and Medium Enterprises (MSMEs) in Nigeria

Date: 08 March 2012

Enhancing Financial Innovation & Access

Authors

Richard Ketley

Neil Lightfoot

Marcel Jakubec

Megan Little

www.genesis-analytics.com

Table of Contents

EXECUTIVE SUMMARY 1

1. INTRODUCTION 3

2. MSMES IN NIGERIA: THE CHALLENGES THEY FACE 4

3. REVIEW OF CREDIT PROVISION TO MSMES...................................... 6

3.1. CURRENT STATE OF CREDIT PROVISION TO MSMES 6

4. BARRIERS TO PROVIDING MSME FINANCE 9

4.1. FINANCIAL INSTITUTIONS' REASONS FOR NOT PROVIDING FINANCE TO MSMEs.. 9

4.2. SMEs REASONS FOR NOT APPLYING FOR LOANS......................... 10

5. REVIEW OF INTERNATIONAL BEST PRACTICE IN SUPPLY SIDE INTERVENTIONS.. 12

5.1. TYPICAL SUPPLY SIDE INTERVENTIONS....................................... 12

5.2. ASSESSMENT OF THE INTERVENTIONS... 34

6. SUPPLY SIDE INTERVENTION IN NIGERIA 43

6.1. REGULATORY ENVIRONMENT 43

6.2. ENABLING ENVIRONMENT 47

6.3. PARTIAL CREDIT GUARANTEE SCHEMES 48

6.4. STATE OWNED ORGANISATIONS 51

6.5. APEXES AND WHOLESALE FUNDING.. 54

6.6. SUPPLY SIDE CAPACITY BUILDING 56

6.7. OTHER 58

7. INTERVENTIONS THAT SUPPORT MSMEs: DESIGN CRITERIA FOR NIGERIA.. 61

8. EVALUATION OF PUBLIC INTERVENTIONS IN NIGERIA................. 65

9. KEY ISSUES REQUIRING FURTHER INVESTIGATION 73

APPENDIX.. 74

BIBLIOGRAPHY.. 79

List of Figures

Figure 1: Are SME Loans More Costly/Risky/Profitable Than Those to Larger Enterprises 10
Figure 2: Reasons SMEs do not Apply for Loans ... 10
Figure 3: Common Reasons for Rejection ... 11
Figure 4: Microfinance Market Penetration in Countries With And Without Interest Rate Ceilings ... 14
Figure 5: New Indemnity Applications ... 26
Figure 6: Credit Decision Process Dimensions ... 34
Figure 7: Sectoral Contribution to GDP, 2009 ... 49
Figure 8: The Levels that Support Public Policy Initiatives ... 61
Figure 9: The Nigerian Landscape ... 62
Figure 10: Comparison of Complexity, Cost, Sustainability and Scalability of Nigeria's Main Initiatives ... 67
Figure 11: Summary of Report Findings ... 71

List of Tables

Table 1: Commercial Market Segmentation ... 5
Table 2: Seven Pillars of PCG Design ... 19
Table 3: Eligibility Criteria Examples ... 19
Table 4: Coverage Ratio Examples ... 21
Table 5: Fee Examples ... 22
Table 6: Recovery Rates and Duration ... 23
Table 7: Collateral and Down Payment Examples ... 24
Table 8: Operational Mechanism Types ... 24
Table 9: Country Adoption of Operational Mechanisms ... 25
Table 10: Effects on the Credit Decision Process ... 36
Table 11: Cost / Effectiveness of the scheme ... 39
Table 12: Segment Impact ... 41
Table 13: Definition of MSMEs ... 43
Table 14: BOI Progress from 2005-2010 ... 51
Table 15: BOI Retail Portfolio Proportional Values Disbursed (2001-2010) ... 52
Table 16: Five Pillars of NIRSAL ... 59
Table 17: Effect of Nigerian Initiatives on the Credit Decision Process ... 65
Table 18: Effect of Nigerian Initiatives on the Credit Decision Process ... 66
Table 19: Impact of Nigerian Initiatives on the MSME Segments ... 68
Table 20: Cost Effectiveness of Schemes in Nigeria ... 75
Table 21: Cost Effectiveness of Schemes in Nigeria ... 76
Table 22: Cost/Effectiveness of Schemes in Nigeria ... 77
Table 23: Cost/Effectiveness of Schemes in Nigeria ... 78

List of Boxes

Box 1: The Effects of Interest Rate Caps on the Microfinance Landscape ... 14
Box 2: Case Study - Directed Lending in India ... 15
Box 3: Case Study - Credit Bureau Success in Uganda ... 16
Box 4: Case Study - Collateral Registry at the Bank of Ghana ... 17
Box 5: Case Study - FOGAPE Chile ... 20
Box 6: Case Study - Khula (South Africa) ... 26
Box 7: Case Study - Banco Estado (Chile) ... 29
Box 8: Case Study - South Asia Regional Apex (SARA) Fund (India) ... 30
Box 9: Case Study - IFC's Financial Markets Technical Assistance (FMTA) Activities ... 31
Box 10: Case Study - Shared Growth Challenge Fund (SGCF) ... 32
Box 11: Case Study - Prizes to Drive Financial Innovation in Haiti ... 32
Box 12: Reduction in Re-offenders Amongst Male Prisoners (UK) ... 33

EXECUTIVE SUMMARY

Micro, small and medium enterprises (MSMEs) play a pivotal role in an emerging economy, driving growth from the informal sector and promoting equitable development through the generation of employment amongst low-skilled individuals at a low capital cost. This is especially true in Nigeria with its large informal sector, however as is the case all over the world, MSMEs have struggled with a number of growth barriers – one of the most commonly cited is the inability to successfully access credit. The Nigerian government has recognised this as a key growth constraint and has consequently introduced a number of public interventions to help boost MSME's access to credit. Genesis Analytics, a strategic advisory firm, was commissioned by EFInA (Enhancing Financial Innovation & Access) to review the Nigerian MSME market and assess the effectiveness of the range of public interventions that have been introduced to help boost credit access for MSMEs in Nigeria.

Extensive research and interviews with a wide range of stakeholders[1] revealed that the Nigerian government is investing quite substantially in a range of public interventions to support access to credit for MSMEs. These include a number of regulations such as the National Policy on MSMEs and the Revised Microfinance Policy, Regulatory and Supervisory Framework for Nigeria, 2011, which have helped to define the landscape and regulate the activities of microfinance banks (that typically provide loans to Micro firms). Furthermore, the government has been supporting and regulating developments in the enabling environment such as the introduction of credit bureaus and registries which have helped to ease information asymmetries of loan applicants.

Whilst these developments must be commended there remain two major additions to the regulatory and enabling environment in Nigeria that would help ease MSME's access to credit and more generally contribute to economic growth and stability. The first is the simplification of Nigeria's fairly complex taxation laws. This would reduce both the cost burden and time required by MSMEs to navigate the system. The second is the introduction of a unique national identification (ID) scheme which would help financial institutions to accurately identify their customers – thereby reducing the costs of tracking down customers who default on repaying their loans. In 2007, the Federal Government charged the National Identity Management Commission (NIMC) with establishing, operating and maintaining the nation's identity system. In March 2012, NIMC launched the National Identity Database which is expected to incorporate all citizens' data into a single database. However, until all Nigerians have been enrolled, assigned unique numbers and provided ID cards, it will remain a challenge for financial institutions to identify their customers.

In addition to the regulatory and enabling environment support, there have also been a number of more direct interventions in Nigeria such as partial credit guarantee schemes (PCGs) where the government and the Central Bank of Nigeria (CBN) provide proportional guarantees to financial institutions in the event that the borrower fails to repay their loan. The Agricultural Credit Guarantee Scheme (ACGSF) and the Small and Medium Enterprise Guarantee Scheme (SMECGS) are both examples of PCGs in Nigeria. Our analysis highlights that modifications to the operations of these schemes are required to improve their effectiveness, and in particular

[1] Interviews were conducted by Genesis Analytics and EFInA representatives in both Lagos and Abuja in January 2012. The stakeholders interviewed are listed in the Appendix.

relaxing some of the collateral requirements of these PCGs could help to enable greater reach amongst MSMEs. This is because both MSMEs and banks in Nigeria identified inadequate collateral as one of the major constraints in getting credit.

The Nigerian government and the CBN have also been active in the provision of wholesale funding to financial institutions – launching the Fund for Refinancing and Restructuring the Manufacturing Sector, the Agricultural Credit Support Scheme (ACSS) and the Commercial Agricultural Credit Scheme (CACS) to provide low-cost funding to be on-lent by financial institutions in Nigeria. Whilst these are sizeable wholesale investments that have provided well-timed liquidity to Deposit Money Banks (DMBs), they have achieved less success in reaching Microfinance Banks (MFBs). As it is the MFBs that are struggling the most with funding constraints, adjusting the wholesale funding schemes to target MFBs may successfully ease these constraints and thereby reach out to the MSME sector, that typically utilise the MFBs for credit.

A third area of focus has been the provision of supply side capacity building that has largely been driven by two agencies - the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) and the Rural Finance Institution Building Program (RUFIN). Whilst both organisations are engaged in a wide variety of programs, the former in particular has been unable to reach significant scale through their initiatives. Greater coordination between these agencies and other development agencies in Nigeria may help to generate innovative solutions to amplify their scale (crucial in a country as populous as Nigeria).

The final type of intervention analysed in this report is the fostering of innovation through development grants. Whilst there is little evidence of this type of funding presently in Nigeria it is apparent the Nigerian Incentive Based Risk Sharing System for Agriculture (NIRSAL) will incorporate an incentives based innovation fund as part of its program. Whilst NIRSAL has not been formally launched, the proposed funding will look to develop both insurance products and long-term agricultural lending capabilities amongst financial institutions. As many MSMEs operate in agriculture it is anticipated that this could have a positive impact on access to credit for MSMEs.

From the analysis of these public interventions, designed to support access to credit for MSMEs in Nigeria, it is clear that although the Nigerian government and the CBN have been very actively involved in these interventions, there are a number of important adjustments that could help to optimise the performance of this funding. In particular, modification of the PCG schemes and greater funding support to microfinance banks are crucial; and greater attention is required to the monitoring and evaluation of these interventions.

1. INTRODUCTION

Although not immune to the effects of the global economic crisis, Nigeria remains a large and rapidly growing economy with a competitive banking sector. Despite the competitiveness of the banking sector, credit extension to the micro, small and medium enterprises (MSME) sector is extremely low with less than 10% of MSMEs reporting receiving a loan from a Deposit Money Bank (DMB) and with MSME loans accounting for approximately 5% of the DMBs' lending portfolios.[2] Whereas this is not uncommon from an international perspective (13% of DMB portfolios in other developing countries globally), this needs to be viewed in the context of the Nigerian economy. Although it is hard to exactly quantify the size of the MSME sector in Nigeria, current estimates suggest there are between 10 and 50 million enterprises[3] accounting for 50% of the total MSMEs in sub-Saharan Africa[4].

As is the case all over the world, MSMEs face a plethora of problems in their quest for growth, and one of the most commonly cited is the lack of credit, with a large number of MSMEs in Nigeria raising this as a concern[5]. For their part, financial institutions have often viewed the MSME market as being too high risk, given the lack of reliable financial statements and the inability of MSMEs to provide collateral that is acceptable to the bank.

The Nigerian authorities are increasingly focused on the social and economic potential of the MSME sector, and in particular how to improve the supply of credit. A large number of Nigerian government and donor initiatives that have been launched to boost the supply of credit for MSMEs by addressing the different factors that constrain credit provision.

This report aims to map and assess these public sector interventions that seek to improve the supply of finance – so called '*supply side interventions*'. The report is organized as follows:

- **Section 2** outlines the role of MSMEs in Nigeria and explores some of the problems that they have identified in their quest for growth.
- **Section 3** reviews the range of credit providers that serve the MSME sector in Nigeria.
- **Section 4** outlines the barriers financial institutions face in supplying finance to the MSME sector.
- **Section 5** reviews international best practice in terms of supply side interventions.
- **Section 6** maps and describes the various significant supply side interventions in Nigeria.
- **Section 7** describes the Nigerian MSME landscape and how the country's characteristics should influence the design of interventions.
- **Section 8** evaluates the success of the different interventions.
- **Section 9** outlines key issues which require further analysis.

---

[2] The World Bank, 2012
[3] An enterprise is loosely defined here to cover both formal and informal businesses. The lack of a reliable business registry for the sector makes an accurate estimate of the number of MSMEs difficult however our interviews with a variety of MSME stakeholders in January 2012 suggested there are between 10-50 million.
[4] IFC SME conference, 2011
[5] The World Bank, 2012

2. MSMES IN NIGERIA: THE CHALLENGES THEY FACE

While limited research has been conducted to quantify the exact size of the MSME sector in Nigeria, various estimates by industry experts suggest that there are between 10 and 50 million enterprises operating at present.[6] Studies carried out by the International Finance Corporation (IFC) over the past decade suggest that 96% of all Nigerian enterprises fit into the MSME classification, although there are no accurate estimates of their contribution to Gross Domestic Product (GDP)[7]. Developing countries in Asia, however, report MSME GDP contributions of 40%, with more developed countries such as the United States of America (US) or those in Europe with upwards of 50%.

The importance of the MSME sector globally cannot be overemphasized. MSMEs play a pivotal role in an emerging economy, driving equitable growth amongst low-skilled individuals that may otherwise face unemployment. In addition, MSMEs also generate less tangible benefits by nurturing an entrepreneurial spirit, encouraging innovation and helping to develop a group of individuals with basic business skills from which a new set of corporates may in the future emerge.

Although the title MSME suggests a single category of enterprise, the moniker masks considerable (and important) differences between firms. Across the African continent, research by the IFC suggests that 90% of all MSMEs are informal or micro, with the remaining 10% being the formal SMEs[8] (8.6% are small and 1.4% medium)[9]. In Nigeria, the National Policy on Micro, Small and Medium Enterprises (MSMEs) defines micro enterprises as employing less than 10 people with assets (excluding land and buildings) of less than N 5 million (USD 32 000[10]), small enterprises as between 10 – 49 employees and assets between N 5 - N 50 million (USD 32 000 - USD322 000), whilst medium enterprises are those with between 50 and 199 employees and assets between N 50 – N 500 million (USD 322 000 - USD 3.2 million). Table 1 summarizes the segments.

---

[6] Genesis Analytics and EFInA interviews, 2012
[7] Oyeralan-Oyeyinka (undated) presentation suggests a figure of 1%, but this seems too low
[8] IFC, 2010 – it must be noted that these numbers could be skewed towards the small and medium enterprises as the definition used is not aligned to that of an MSME in Nigeria. While the number of employees is the same, turnover or asset estimates are significantly higher
Micro – Turnover <= USD 2 million (N 310 million)/ Assets: <= USD 2 million (N 310 million)
Small – Turnover <= USD 10 million (N 1.55 billion)/ Assets: <= USD 10 million (N 1.55 billion)
Medium – Turnover <= USD 50 million (N 7.75 billion)/ Assets: <= USD 43 million (N 6.665 billion)
[9] IFC, 2010
[10] Using a N (Naira) to USD (United States Dollar) exchange rate of 155:1

Table 1: Commercial Market Segmentation

	Employees	Turnover (annual N million)	Turnover (annual USD)	Asset Value (N million)	Asset Value (USD)
Micro	0 – 10	0 – 10	0 – 65 000	5 million	32 000
Small	10 – 49	10 – 100	65 000 – 650 000	5 – 50 million	32 000 – 320 000
Medium	50 – 199	100 – 500	650 000 – 3.2 million	50 – 199 million	320 000 – 1.2 million

Source: Federal Republic of Nigeria, *National Policy on Micro, Small and Medium Enterprises*, brochure undated

The official Nigerian definition differs from the IFC definition in that the ranges provided by the IFC are a lot wider. The IFC micro classification includes firms that would be considered medium using the official Nigerian definition, suggesting in fact that close to 98% of MSMEs in Nigeria are micro by international standards. Similar definitional issues arise nationally with banks creating their own segments and aligning them to their own operations rather than the national policy. This disconnect between definitions makes national and cross country analysis extremely difficult, and is an important factor to consider when linking government interventions to the various segments, and assessing the effectiveness of the interventions.

Across the different segments both the needs of the MSMEs and the way in which financial institutions view them differ widely, micro firms are seen as posing the highest risk (given that many may not have generated sufficient profit to expand their businesses, often lack the financial education to develop financial reports and have little tangible collateral).

MSMEs face a number of special challenges in their quest for survival and growth in Nigeria. Their biggest constraints to growth are a lack of access to finance, poor infrastructure and difficulty in getting machines/spare parts/raw materials and skills and training[11]. Access to credit does however consistently top the list. In a survey conducted in 2009[12], it was estimated that less than 10% of SMEs have a loan with a bank, whereas a World Bank report (Nigeria SME Finance, 2012) highlights that only 3% of working capital and 2% of fixed assets are financed by banks. Notably this constraint is heightened amongst the very smallest firms, with 59% of small firms reporting difficulties in accessing finance, 35% of medium firms and only 11% of the larger SME firms facing difficulties. Micro firms were not separated from small firms in the survey, but the nature of micro firms suggests that their problem would be even more acute than those of small firms.

[11] Mambula, C. 2002
[12] Isern, J., Agbakoba, A., Flaming, M., Pellegrini, G. and Tarazi, M. 2009

3. REVIEW OF CREDIT PROVISION TO MSMES

3.1. CURRENT STATE OF CREDIT PROVISION TO MSMES

3.1.1. KEY CREDIT PROVIDERS

Banks

There are currently 21 DMBs[13] in Nigeria, with varying strategies and focus. DMB lending in Nigeria currently amounts to approximately 35% of GDP of which 5% applies to the MSME sector equalling about N 468 billion (USD 3 billion)[14]. For the most part in Nigeria (and elsewhere globally) DMB typically classify MSMEs as part of the retail segment.

Many DMBs view MSMEs as inherently risky given that they lack formal financial histories and often do not have the required collateral. Although it is inevitable that all banks will have some exposure to small businesses, not all explicitly provide targeted services to meet the special needs of the different sub-segments. There are a few exceptions to the norm however such as Diamond Bank who has marketed itself as an SME bank. Diamond Bank has developed relationships with multilateral agencies organizations such as the International Finance Corporation (IFC) who gave the Bank USD 20 million (N 3.1 billion) to support MSME growth. Diamond Bank has grown its loan portfolio to MSMEs from N 3.74 billion (USD 24.1 million; 863 customers) in 2009 to N 10.3 billion (USD 66.4 million; 3,385 customers) by the end of 2010. Latest figures for the first Quarter 2012 announced by Diamond Bank are N 30 billion to 14,000 SME borrowers.[15]

Microfinance Banks (MFBs)

Currently there is a vast array of MFBs in Nigeria (over 800) which include unit MFBs, state MFBs and national MFBs. Collectively MFBs are much smaller than the banks with a total lending portfolio of N 53 billion (USD 342 million)[16] to the sector. Regulations by the Central Bank of Nigeria (CBN) require MFBs to lend at least 80% of their loan portfolio to micro enterprises.

Three categories of MFBs have been defined by the Central Bank with varying capital requirements and restrictions in terms of number of branches and geographical spread:

- Unit Microfinance Bank: Authorized to operate in one location with a minimum paid up capital of N 20 million (USD 129 million). Prohibited from having branches and cash centres.

---

[13] Central Bank of Nigeria, 2012a - Including the merger between Ecobank and Oceanic Bank, FCMB and FinBank, and Intercontinental Bank and Access Bank

[14] Central Bank of Nigeria, 2011b – The CBN highlights a figure of 0.18% of bank lending being directed towards Small Scale Enterprises. We believe this figure is an underestimate as the definition provided by the CBN for a Small Scale Industry include those with a total cost (including working capital but excluding land) of between N 1 million and N 40 million (USD 6 450 – USD 258 000) and with a labor size of between 11 and 35 workers. Medium Scale Industries were defined as those with costs of between N 40 million (USD 258 000) and N 150 million (USD 970 000) and with labor size of between 36 and 100 workers. These definitions are clearly not in line with the official definitions (excluding even micro), and therefore excludes a large majority of what banks are providing for up to the official definition of N 500 million

[15] Proshare Intelligence Investing, 2012

[16] Central Bank of Nigeria, 2012b

- State Microfinance Bank: Authorized to operate in one State or Federal Capital Territory (FCT) and required to have minimum paid up capital of N 100 million (USD 645 000). Allowed to open branches within the same state of FCT subject to prior written approval from the CBN for each new branch.
- National Microfinance Bank: Authorized to operate in more than one State of FCT and required to have minimum paid up capital of N 2 billion (USD 12.9 million). Allowed to open branches in all States and FCT with written prior approval from the CBN. Notably, for a State MFB to become a National Microfinance Bank, they need to have at least 5 branches spread across Local and Government Areas in the State.

MFBs in Nigeria differ from those in other emerging markets in that the majority are privately owned rather than donor funded or governed. As such, the mandate of MFBs in Nigeria is often profit driven rather than led by a social agenda of greater financial inclusion.

The distribution of MFBs across Nigeria is uneven, with the greatest concentration being in Abuja, Anambra, Lagos, Ogun and Oyo.[17] Despite the high number of operating MFBs, only 3.8% of adults have an account with an MFB (compared with the 30% who have an account at a DMB).[18] In a survey on constraints to their operations, MFBs cited the lack of credible information on borrowers as one of their constraining factors and they argued that a credit registry that covers their customers would be of huge benefit to their businesses.[19] Furthermore MFBs found the geographical restrictions and reporting requirements imposed by the CBN, restricting and burdensome.

The financial crisis had widespread effects on MFBs. Firstly, the fall in consumer confidence in the financial sector led to widespread withdrawals of deposits at DMBs and MFBs, which in some severe cases led to bankruptcy for some MFBs. Secondly, in response to the heightened perceived financial risks MFBs tightened their credit policies. The challenges faced by many of the MFBs have prompted a review of the Microfinance Policy framework and regulations, which is explored later in this report. Nonetheless, as it currently stands, MFBs have been unable to profitably provide the kind of products required to meet the credit needs of a significant number of micro enterprises.

Equipment leasing[20]

For MSMEs that cannot access conventional collateral, equipment leasing is an important source of credit, typically sourced from small independent financial and leasing companies. These companies for the most part do not accept deposits and so their cost of funding is high (estimated between 22-30% per annum[21]). As such, MSMEs that utilize the equipment leasing option are usually forced to pay high repayment instalments on the equipment (on average between 25-50% of the value of the good). Despite these high costs, equipment leasing remains popular as MSMEs find it easier to lease equipment than obtain a formal loan due to the less stringent compliance requirements.[22]

[17] CBN Data
[18] EFInA, 2010
[19] World Bank, 2012
[20] Isern, 2009
[21] ibid
[22] ibid

In Nigeria there now over 250 companies that provide some sort of leasing option (including banks, independent leasing organizations, insurance companies and vendors of capital equipment). Between 2003 and 2009, volumes in the industry (as measured by gross lease receivables) grew from N 60 billion to N 450 billion (USD 387 million to USD 2.9 billion).[23] The Equipment Leasing Association of Nigeria (ELAN) estimated that 38% of leasing transactions that have occurred over the past 15 years have been for MSMEs.[24] This would suggest that MSMEs received leasing finance of approximately N 171 billion (USD 1.1 billion) in 2009; however only a small proportion of this would have been supplied by non-bank finance companies. More importantly, there is currently no leasing law in place and the leasing companies are not regulated by the CBN which leaves MSMEs vulnerable to exploitation.[25]

[23] Opara, S., *Maximising leasing finance options for SME growth*, 2011http://www.nigerianbestforum.com/generaltopics/?p=91284, Accessed: 19 Feb 2012

[24] op.cit

[25] Isern, 2009 & All Africa 2011

4. BARRIERS TO PROVIDING MSME FINANCE

4.1. FINANCIAL INSTITUTIONS' REASONS FOR NOT PROVIDING FINANCE TO MSMEs

Although the MSME sector represents a sizeable market, financial institutions are wary of providing credit to this market for a number of reasons.[26]

- MSMEs lack the requisite collateral (and most banks continue to require collateral for lending purposes).
- MSMEs lack a formally recorded and audited financial history to be used to assess the profitability and cash flow of the business (and thus evaluate likelihood of loan repayment).
- MSMEs may lack formal registration documents for their businesses and rent agreements for their plots or buildings to help identify and locate the business.
- The absence of a unique national ID system is problematic for institutions attempting to follow up businesses and their owners.

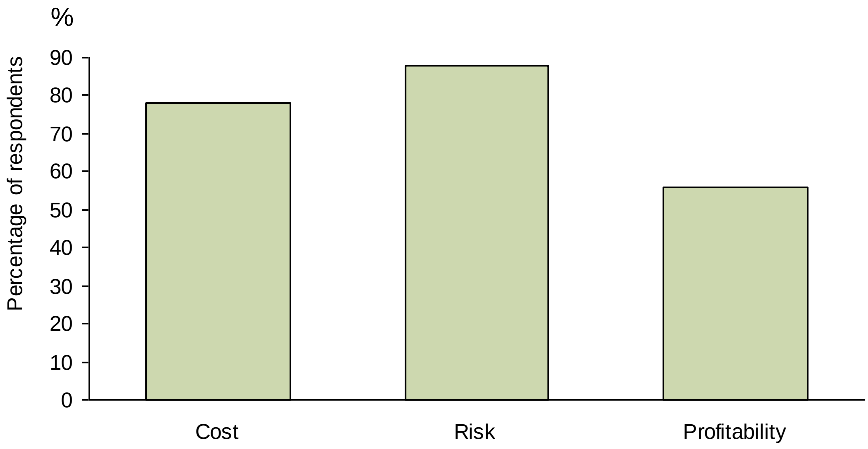
As such, financial institutions view MSMEs as highly risky and to compensate for this risk the loans typically made available to MSMEs have high collateral requirements, high interest rates and short loan maturities. In some instances, to reduce the risks, loans are typically made available to MSMEs operating in sectors that are perceived to be less risky and those that are deemed to be high risk such as the health sector are usually excluded.

Furthermore, financial institutions often view MSMEs as costly to serve. This is because small business owners usually require bank employees to explain financial procedures and implications to them (and this time spent is expensive). Banks typically like to visit the MSME premises and do check-ups to ensure that the business is on track. These visits are often costly to conduct as the MSME may not be in an easy to reach location. More broadly, banks often find that they apply similar processes (costs) to approve a MSME loan, as they would for a loan to a corporate despite the much lower revenue potential. To compensate for these costs financial institutions need to charge a premium which may make their products unattractive to the MSME.

Figure 1 below indicates the financial institutions' view of whether lending to SMEs in Nigeria is more costly, risky or profitable than lending to large enterprises. Clearly, most financial institutions felt that it was more risky, whilst many also felt it was costly, but most importantly they did view it as profitable, suggesting a willingness to engage with the segment providing costs can be reduced, or risks can be managed.

[26] World Bank, 2012

Figure 1: Are SME Loans More Costly/Risky/Profitable Than Those to Larger Enterprises?

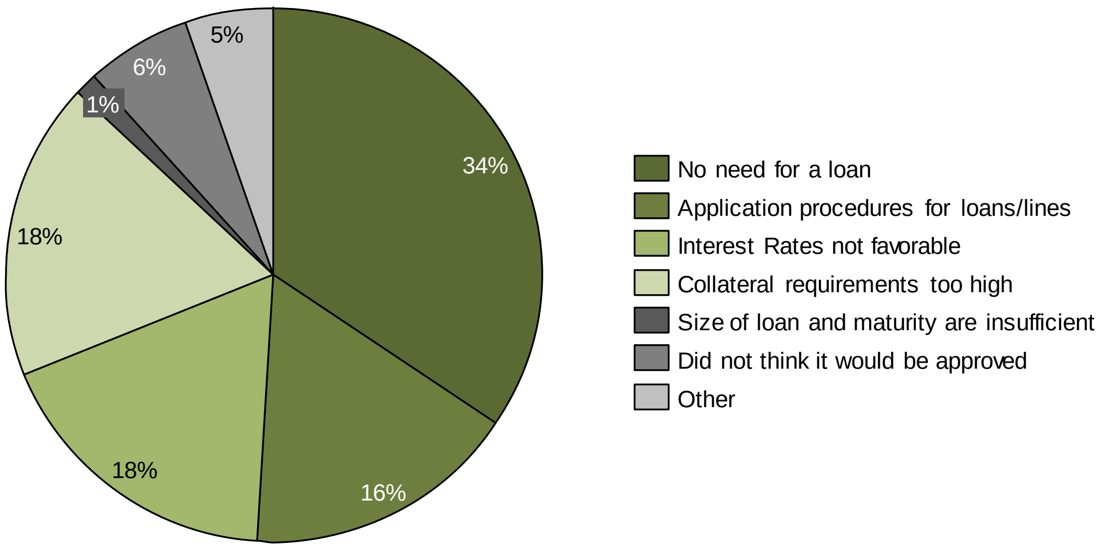


Source: World Bank, 2012

4.2. SMEs REASONS FOR NOT APPLYING FOR LOANS

The recently completed World Bank, Nigeria SME Finance report (2012) revealed that the main reasons for SMEs not applying for loans through the formal channels in descending order are interest rates not being favourable, the collateral requirements being too high and finally the application procedures being a deterrent.

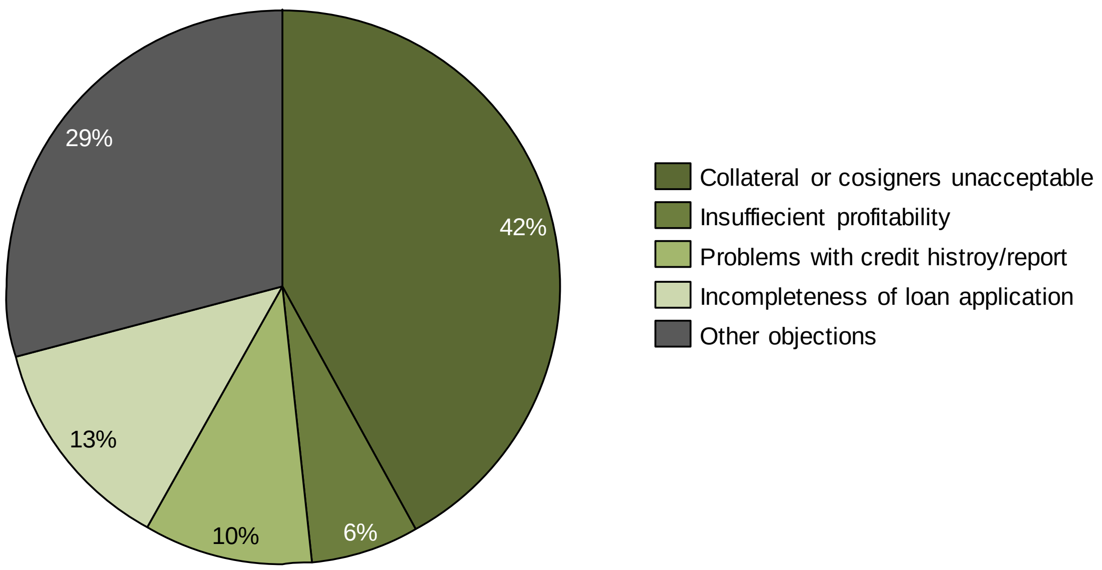
Figure 2: Reasons SMEs do not Apply for Loans



Source: World Bank, 2012

For the firms that did apply for loans, on average 60% (2010) of them were rejected, a figure which has declined from 69% in 2007. This is an extremely high number, by comparison in South Africa's banks report a rejection rate of 22% for MSME loan applications. The main reasons cited for not qualifying for a loan are insufficient collateral, incompleteness of loan application and problems with credit history.

Figure 3: Common Reasons for Rejection



Source: World Bank, 2012

Both the supply and demand side analysis therefore suggests that there are a range of issues that need to be addressed if lending to MSMEs is to increase substantially. Close to the top of this list is how to overcome a lack of collateral or collateral of sufficient quality for MSMEs. Improving the quality of information available from MSMEs is also prominent. Perceived high interest rates are symptomatic of the costs and risks of servicing the sector. Many of these issues are experienced by MSMEs globally. The next section reviews the main types of public interventions that have been used across the world by governments seeking to increase the supply of credit to the MSME sector.

5. REVIEW OF INTERNATIONAL BEST PRACTICE IN SUPPLY SIDE INTERVENTIONS

As noted in section 4, although the challenges faced by MSMEs in Nigeria are probably more extreme than elsewhere, many of the interventions adopted by governments across the world are similar. Our review of international best practice suggests that there are 7 broad categories of supply side interventions that governments and other public entities use to encourage lending by financial institutions to MSMEs. These initiatives are listed below, and are then described in more detail in Section 6 with case studies highlighting some the effective and unsuccessful initiatives which exist globally):

1. General regulatory environment
2. Enabling environment
3. Partial credit guarantees (PCGs)
4. State and donor organizations
5. Apexes and wholesale funding
6. Supply side capacity building
7. Encouraging innovation

TYPICAL SUPPLY SIDE INTERVENTIONS

5.1.1. GENERAL REGULATORY ENVIRONMENT

At the highest level, government interventions to support MSME credit extension need to be guided by an overall policy framework.

Action plans and targets

Globally, governments are becoming increasingly pro-active in setting financial inclusion targets, including for MSME financing, as part of the development agenda. A survey by the World Bank found that at least one financial inclusion policy or intervention is under the guidance of the financial regulators in 90% of economies surveyed.[27] The promotion of MSME finance is part of financial inclusion in most countries.

A starting point for advancing high level financial development is to establish key principles that guide the countries' actions. These principles, as per the recommendations provided by the IFC, are listed below[28]:

- Leadership – cultivate a broad-based government commitment to help alleviate poverty.

[27] IFC, 2011a
[28] IFC, 2011a

- Diversity – implement policy approaches that promote competition and provide market-based incentives (such as tax incentives, fines or subsidies) for delivery of sustainable financial access and usage of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers.

- Innovation – promote technological and institutional innovation as well as addressing infrastructure weaknesses as a means to expand financial system access and usage.

- Protection – encourage a comprehensive approach to consumer protection that recognizes the roles of government, providers and consumers.

- Empowerment – develop financial literacy and financial capability.

- Cooperation – improve co-ordination within government entities that seek to promote financial access (Central Bank, Ministry of Finance, Ministries for Trade and Industry, Cooperatives etc.); and also encourage partnerships and direct consultation across government, business and other stakeholders.

- Knowledge – utilize improved data to make evidence based policy, measure progress, and consider an incremental 'test and learn' approach acceptable to both regulator and service provider.

- Proportionality – build a policy and regulatory framework that is proportionate with the risks and benefits involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.

- Regulatory Framework – that reflects international best practice and local conditions with respect to Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime; conditions for the use of agents as a customer interface; a clear regulatory regime for electronically stored value; and promoting interoperability and interconnection within the payments system.

Legislative Measures

Governments also attempt to promote improved access to credit through strict directives which attempt to either make credit more affordable (through interest rate caps) or available to targeted groups (through directed lending)[29]. By definition, these initiatives tend to be distortionary and if widely applied can undermine the ability of the financial sector to conduct risk-based financial intermediation. Exemptions to specific regulations to encourage specific activities such as reduced reserve requirements for an amount equal to SME lending volume by a bank have also sometimes been adopted.

Setting Interest rate caps, or maximum interest rate levels at which financial institutions are able to lend, will discourage lending as it prescribes the upper price of credit, even if the institutions' risk assessments meant that a higher interest rate should be charged (to maintain their margins). The end result is that the institutions would choose not to lend and therefore the credit available to the market will dry up. Regulated ceilings on interest rates have thus proved to be an ineffective or even counterproductive measure against predatory lending and

[29] IFC, 2011a

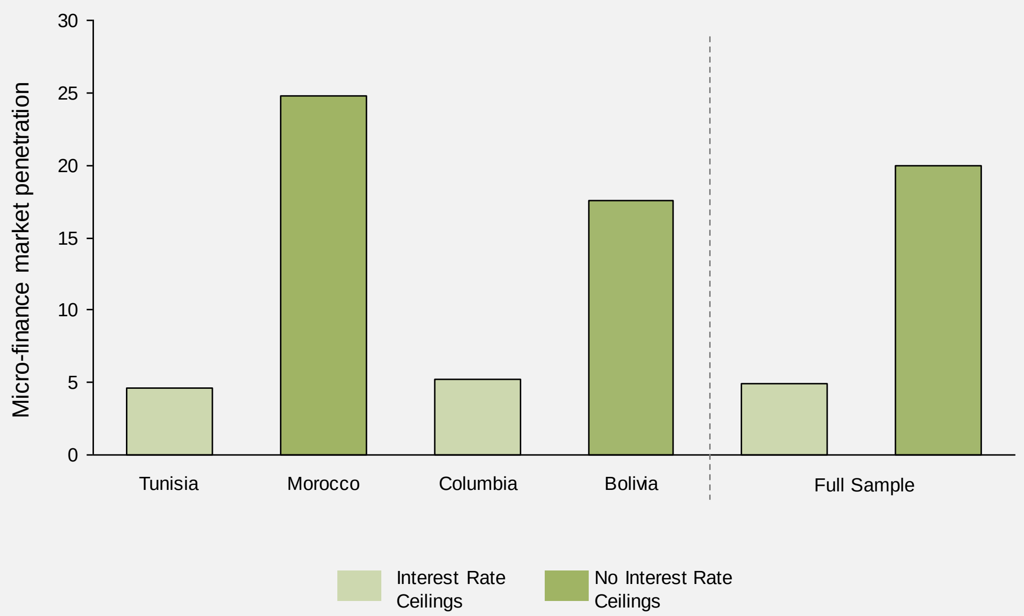
have often tended to work against increasing access[30]. Where such ceilings are retained, they should be pitched at realistic levels in relation to costs in each market segment and adjusted over time, in line with movements in the wholesale cost of funds. A dynamic interest rate cap would require excessive monitoring and assessment in order to be sustainable; therefore Governments should not lightly undertake this initiative[31].

Box 1: The Effects of Interest Rate Caps on the Microfinance Landscape

While it is difficult to substantiate arguments about what specific markets look like without interest rate ceilings, a comparison of market penetration rates between 23 countries with interest rate ceilings[32] and 7 countries without ceilings[33] suggests higher penetration rates in the latter. On average, the former had a market penetration of 4.6%, whereas countries without interest rate ceilings, or ceilings that had little impact on microcredit, enjoyed penetration rates of 20.2%, more than four times higher (see Figure 4).

Market penetration figures for two sets of countries with similar characteristics are also shown in Figure 4, a comparison that sheds further light on the possible effects of interest rate ceilings. Morocco and Bolivia clearly have significantly higher market penetration rates than their respective peers. One factor (among many) that differentiates the two set of countries is the restrictive interest rate ceiling, whether legal or de facto, that exists in countries with low penetration rates. It should be noted that structural problems related to large-scale state intervention in financial systems, not simply interest rate ceilings, have a significant impact on microfinance in many countries, including Tunisia.

Figure 4: Microfinance Market Penetration in Countries With And Without Interest Rate Ceilings



Source: Reille. X, Helms, B., 2004

[30] IFC, 2011a
[31] IFC, 2011b
[32] The countries with interest rate ceilings are Armenia, Brazil, Burkina Faso, Cameroon, Central African Republic, Chile, China , Colombia, Cote d'Ivoire, Ecuador, Ethiopia, Guatemala, Honduras, Laos, Mali, Nicaragua, Niger, Paraguay, Senegal, South Africa, Tunisia, Venezuela, and Vietnam
[33] The countries without interest rate ceilings are Bangladesh, Bolivia, Egypt, Indonesia, Morocco, Peru, and Sri Lanka

Directed Lending

Experience of directed lending, where governments direct banks to lend to specific regions or sectors in order to develop them, or overcome some market failure, is equally mixed[34]. The evidence shows it often fails to reach intended beneficiaries, generates distortions in the market, and provides incentives for bribery, corruption and cronyism in order to circumvent the constraints. While in principle directed lending could raise access to credit for certain favoured groups, it reduces it for others, and is likely to undermine financial sector development more generally (forcing the market in one direction could lead to other areas being neglected), with negative consequences for overall access to financial services. Nonetheless, many governments do promote certain forms of directed lending, including towards SMEs. The potential economic and social benefits of directed lending need to be compared and balanced with the potential costs and distortionary impact.

Box 2: Case Study - Directed Lending in India

As part of India's priority sector lending requirements, a target of 40% of net bank credit has been stipulated for lending to the priority sector by domestic commercial banks (32% of foreign banks' net credit). Within this, a sub-target of 18% has been specified for lending to agriculture.

While the definition of priority sector has been widened over the years (originally defined as Agriculture and small scale industries, but later expanded to include small service businesses, education and housing[35]) the program is fraught with targeting problems, with banks not being able to identify suitable lending partners within the designated sectors.

Though priority sector lending for banks continues, microfinance is being recognized as an alternative and an effective tool for promoting rural finance.

Source: World Bank, 2008

Internationally, the consensus (and evidence) suggests that interest rate caps and sector specific lending targets can actually reduce access to finance for MSMEs; and if widely applied, undermine the effectiveness of risk management and financial intermediation in the banking sector. Forcing an institution down a path it would not necessarily normally take tends to have the opposite effect to what is desired; usually it will have an adverse effect on revenue and increases risks.

5.1.2. ENABLING ENVIRONMENT

The following initiatives are internationally recognized ways of creating an enabling environment in the market place that encourages greater lending:

- National ID system
- Address registries
- Commercial courts
- Credit bureaus

[34] IFC, 2011a
[35] The Reserve Bank of India, 2007

- Collateral registries

Focus on supporting these various initiatives will help financial institutions reduce the risk associated with lending to the market. A national ID system provides identification information for institutions in order to track and understand their customers. Developing commercial courts and the judicial system, on the other hand, promotes the enforcement of property ownership, thereby instilling confidence in the lender that they are able to recover potential losses. Credit bureaus and collateral registries are described in more detail below.

Credit Bureaus

Credit bureaus play an important role in creating a sound financial infrastructure that facilitates lending to a significant share of the population. In many emerging market countries, agencies that compile and distribute credit and personal information to creditors are underdeveloped or non-existent. These institutions can be either private or public in their nature. For instance, in Mauritius the market was considered too small for the successful operation of a private sector bureau and as a result the central bank undertook to provide such services. Well designed and executed credit bureaus support the lending business by providing lenders with better information on a borrower's credit history.

The IFC[36] suggests that for a credit bureau to be successful it needs to incorporate six fundamental qualities:

1. Contain both positive and negative information.
2. Contain data on all loans.
3. Contain data on all types of customers (both individuals and firms).
4. Contain data from all financial institutions in the market, not just retail banks.
5. Guarantee consumers' right to inspect and amend their data.
6. Hold extensive historical records (up to five years).

Box 3: Case Study - Credit Bureau Success in Uganda

An international survey undertaken and published by The World Bank on the ease of doing business, released on 4 November 2010, found that it is becoming easier to get credit for individuals, entrepreneurs, and medium sized companies in Uganda.

Uganda has been ranked against its peers in 183 countries around the world and is now in an admirable position of 46th in the world in terms of the ease of getting credit. This is in comparison to its position of 109th in the previous year.

The key reasons contributing to the overall improvement in rankings for Uganda was deemed to have been the foresight, leadership and direction of the Bank of Uganda in creating a framework for the establishment of a regulated credit bureau in 2004 and 2005 and in overseeing the project's successful implementation.

Source: Compuscan, 2010

[36] Global Partnership for Financial Inclusion, 2011

Collateral Registries

A collateral registry is an institution designed to track and inform the market on the existence of relationships between lenders and borrowers, in relation to movable and immovable collateral. This is important so as to ensure that existing collateral is not being used multiple times at different institutions in order to receive multiple loans. It is important that collateral registration is centralized and housed by one independent source whose main purpose is to react to information changes. A collateral registry needs to conduct the following operations[37]:

- The registration of collateral
- Honour all search requests by institutions on collateral queries
- Process releases on collateral when a loan has been paid off by the borrower
- Process realization requests when the borrower has defaulted and the institution has taken over the asset

The effectiveness of collateral registries will very much depend on the volumes of information it is capable of handling and the extent to which the registry has effective and modern electronic systems and processes.

Box 4: Case Study - Collateral Registry at the Bank of Ghana

A collateral registry was set up in 2008 as a temporary solution for the market, in an attempt to expand SME finance and is currently being upgraded into a web based electronic registry, Some of the highlights of the success of this project include:

- **Increased volume of financing for SMEs:** more than 20,000 loans have been registered by Banks and NBFIs in the collateral registry since its creation in March 2010. These loans account for more than USD 800 million in financing secured with movable property.
- **Wider use of movable assets as collateral by businesses:** businesses and SMEs are now using wider variety of collateral beyond real estate. These types of collateral include: inventory and accounts receivable (in 32% of the loans); investment instruments such as shares, cash, bonds, deposit accounts, etc. (19%); household assets (13%); motor vehicles (10%); real estate property (10%); and machinery, equipment, all enterprise assets, other (16%).
- **Increased financing by banks and non-Bank Financial Institutions taking movable property as collateral:** out of 52 financial institutions, 33 institutions have registered with the collateral registry and granted loans secured with movable property. However, a considerable number of the rural and community banks have still not benefitted from the new infrastructure in place.

Source: Bank of Ghana, 2011

5.1.3. PARTIAL CREDIT GUARANTEE SCHEMES

Partial credit guarantee schemes (PCGs) are used by several countries around the world. PCGs have been operating for over four decades in the developed world, while they are a more recent addition in the developing world. Experience suggests that PCG schemes are one of the most market-friendly forms of intervention, and if well designed generate few distortions

[37] Bank of Ghana, 2011

in the credit market. PCGs require less interference in credit allocation and use private banks as the main vehicles for loan origination and distribution[38]. They are considered effective for reaching underserved groups such as MSMEs, and have the potential to create additional positive effects, through improved lending technologies and risk management systems (the rules for these schemes often prescribe minimum requirements for risk management systems – institutions invest in these so as to qualify).[39]

In a PCG scheme a third party, usually a government agency or a donor organization, will offer a guarantee on the loans offered by financial institutions. This guarantee is an assurance to repay the outstanding loan amount that was provided by the lender if a borrower defaults. PCGs facilitate access to finance to creditworthy firms when such access is constrained by, amongst other things, information asymmetries and lack of collateral. These constraints can lead to an excess demand by SMEs for bank loans under a bank's normal creditworthiness and interest rate criteria. By guaranteeing that the loan amount provided by the financial institution is covered in the case of a default, the institution can afford to loosen its lending requirements. PCGs positively affect the risk dimension of the '*credit decision process*' framework, making the decision to lend to riskier customers easier for the financial institution[40].

PCGs have also been implemented in some instances as a reaction to economic downturns in an effort to avert adverse effects on the SME sector. This action becomes important in situations where the private banks change their risk acceptance criteria to protect themselves from higher expected default rates and therefore curb funding to the market, possibly only willing to provide credit to the safest customers. PCGs attempt to lower this risk threshold imposed by the banks.

Generally, the objectives of a PCG can be defined as outreach, 'additionality' and financial sustainability. Outreach is the corresponding volume effect on the market or the number of loans being disbursed; while 'additionality' measures the additional loans provided as a direct result of the PCG. Sustainability is largely determined by the price charged for the guarantee in relation to the risk acceptance criteria applied.

Design of PCGs

To ensure that it is successful, the design of the scheme is important; as a badly designed PCG could induce both extremes of low or high demand. If the modalities are too restrictive, banks may end up not using the partial guarantee either due to high costs or too much administration and red tape. On the other hand, if they are too lax, moral hazard will creep in on the part of the financial institutions and they will over subscribe by excessively lowering their risk criteria, thereby limiting the sustainability of the scheme. The design of a PCG scheme should revolve around seven pillars highlighted in Table 2 and explained in detail thereafter.

[38] IFC, 2011a
[39] Rocha et al., 2010
[40] Rocha et al., 2010

Table 2: Seven Pillars of PCG Design

Rules Categories	Definition
Eligibility criteria	Characteristics of eligible firms (size, sectors) and eligible financing
Coverage ratio	Percentage of risk taken by the guarantee scheme
Fees	Price of the guarantee
Payment rules	Triggers related to the payment of the guarantee
Collateral and down payment	Collateral and down payment required when using the guarantee
Operational mechanism	Individual, portfolio or hybrid approach
Credit risk management	Credit risk management tools (credit scoring and rating, credit registry)

Source: Rocha et al., 2010

Eligibility criteria

The eligibility criteria for a PCG sets the conditions for which specific industries should be targeted in the market. To ensure 'additionality' (although overly restrictive eligibility criteria in the form of types of loans or eligible sectors could hinder the outcomes of the scheme), it is important to carefully think through the target industries. Eligibility criteria can involve restrictions around whether or not the firm is a start-up, the size of the firm, sectors it is limited to, and finally, whether the loan is for working capital reasons or not. In Table 3, various country PCG schemes and their eligibility criteria are provided.

Table 3: Eligibility Criteria Examples

Country	Industries	Working Capital
Canada	All (except agriculture)	No
Chile	All	Yes
Colombia	All (except agriculture)	Yes
France	All (except for most agriculture firms)	Yes
Hungary	All	Yes
India	All	Yes
Korea	All	Yes
Malaysia	All	Yes
Netherlands	All	Yes
Romania	All	Yes
Taiwan, China	All	Yes
USA	All	Yes
Egypt	All	Yes
Jordan	All	Yes
Lebanon	Agriculture, Industry, Tourism, High Tech, Crafts	Yes
Morocco	All	Yes
Palestine	All	Yes

Country	Industries	Working Capital
Syria	All	No
Tunisia	Manufacturing, some services	No
UAE	All	Yes

Source: Rocha et al., 2010

By focusing on the various criteria mentioned, the scheme managers can tailor the results of the PCG to specific areas/sectors/segments as per the mandate. It is important to align these criteria closely to the outreach, 'additionality' and sustainability objectives of the PCGs.

Coverage ratio

In PCGs the coverage ratio is the percentage of the actual loan provided by the financial institution which is covered by the guarantee. The coverage ratio should preserve incentives for effective loan origination and monitoring, while at the same time, provide sufficient protection to the financial institution against the risk of default. The coverage level can be set in a number of ways, with the most popular being a ratio imposed by the scheme. In Chile for example, a bidding system has been implemented whereby banks bid for a given amount of the guarantee indicating the coverage ratios they are willing to accept for a given level of fees. In this system the bank requesting the lowest coverage ratio would get their loans guaranteed.

Box 5: Case Study - FOGAPE Chile

FOGAPE is a government initiative to increase access to finance to SMEs by providing PCGs to banks in favour of SMEs who lack necessary collateral to gain access to credit, or need longer maturities. FOGAPE functions as a classical guarantee fund, sharing the risk of default on eligible loans and charging a guarantee premium. The commercial relationship is between FOGAPE and the banks. The fund was originally financed by the government, but over time profits from operations contributed significantly to the fund's capital base.

Several features of FOGAPE's operations have been key in reducing moral hazard problems. First, commercial banks share part of the risk of default, as guarantees only cover between 70% and 80% of credit losses[41]. Second, to allocate the available guarantees, Banco Estado (the Chilean State Bank) conducts auctions four to six times per year among participating banks. Each bank has to submit a bid indicating the amount of guarantee it wants to receive and the maximum coverage rate as a percentage of lending. The bids are selected by the lowest coverage required until the total amount auctioned has been assigned; therefore the bidding process determines how the risks are shared among FOGAPE and financial intermediaries. Banks with high default rates on previously guaranteed loans can be permanently or temporarily excluded from participating in the bidding process. This helps to reduce moral hazard, as banks that reduce screening and monitoring today lose profitable opportunities in the future. Also, the use of a bidding process increases competition among financial institutions. Third, the amount of FOGAPE guarantees each bank can obtain is limited: no bank can be awarded more than two thirds of the total rights auctioned. This also helps to reduce moral hazard, as the amount that can be gained by reducing screening and monitoring is reduced. Following the bidding process, banks have three months to grant the corresponding loans.[42]

Source: Rocha et al., 2010

[41] Benavente, et al., 2006
[42] De la Torre et al., 2007

Table 4 highlights the various coverage ratios used by different PCG schemes globally. The average across countries is 69% indicating that most countries realize that some risk must be left in the hands of the bank to avoid moral hazard.

Table 4: Coverage Ratio Examples

Country	Coverage Ratio	Link to Risk Exposure
	Median[43]	
Canada	85%	No scalability[44]
Chile	65%	80% coverage large firms 50% coverage for medium firms[45]
Colombia	60%	According to the type of loan/firm
France	70%	40%-50% in general, 60% innovation, 70% start-ups
Hungary	n/a[46]	Max 80% in general Max 60% in agricultural loans Max 90% firms affected by crisis (2010)
India	80%	75% general 85% on loans to micro firms (less than USD 10 000 or N 1.55 million)
Korea	70%	Depending on firms credit score: Eligible firms with the lowest credit score 90%, firms with the highest get 50% coverage
Malaysia	65%	According to loan/firm
Netherlands	65%	50% in general 60% innovative business 80% start-ups
Taiwan, China	65%	According to loan/firm
USA	80%	75% on loans greater than USD 150 000 (N 23.3 million) 85% on loans less than USD 150 000 (N 23.3 million)
Egypt	60%	Medium firms 50% (> 10 employees) Small firms 75% (<10 employees)
Iraq	75%	No scalability
Jordan	70%	No scalability
Lebanon	82.5%	75% Small sized loans less than USD 200 000 (N 31 million) 85% Medium loans less than USD 400 000 (N 62 million) 90% Innovative loans
Morocco	65%	50% Working capital 60% Fixed assets 80% Start-ups (70% for loans greater than USD 125 000) (N 19.4 million)
Palestine	60%	No scalability
Saudi Arabia	62.5%	50% General 75% Start-ups
Syria	50%	No scalability

[43] The median is calculated by taking the midpoint between the maximum and minimum coverage ratios recorded in the relevant country
[44] The level of scalability is dependent on whether there is variation in the level of coverage. If there is no variability, then there is no scalability in the link to risk exposure
[45] Size of firm is dependent on the sales value and the loan size
[46] A median could not be calculated as no minimum values were recorded

Country	Coverage Ratio	Link to Risk Exposure
Tunisia	67.5%	60% General 75% Prioritized firms (Development zones, start-ups)
UAE	90%	No scalability

Source: Rocha et al., 2010

Fees

The fees charged by the PCG should generally be in line with the risk exposure and contribute to the financial sustainability of the guarantee scheme. On average, fees tend to range from 1.5% to 2.5% of the guarantee, depending on the inherent risk, as outlined in Table 5.

Table 5: Fee Examples

Country	Fees Link to Risk
Chile	Higher fees for banks with higher default rates
Colombia	Fees are linked to the product and coverage ratio
France	Fees are linked to the coverage ratio: 0.6% (40% coverage ratio) 0.9% (70% coverage ratio)
Hungary	Fees depending on the size, vary according to firms' credit ratings
India	Fees are lower for loans up to USD 10 000 (N 1.55 million) (1.25% per annum)
Korea	Higher fees for low credit rating along with higher coverage ratio
Malaysia	Higher fees for low credit rating
Netherlands	Fees are linked to the coverage rating
Taiwan, China	Fees are linked to the risk profile
USA	Higher fees for larger loan amounts
Egypt	Lower fees for health care
Morocco	2% flat in general 0.5% on working capital 1.5% for start-ups <= USD 125 000 (N 19.4 million)
Tunisia	1% flat short-term loan (standardized 1.2%)

Source: Rocha et al., 2010

Payment rules

The payment rules define how banks make claims to the guarantee scheme. These rules should be designed so as to be quick and transparent, which in turn will build the credibility of the scheme while also encouraging loan collection and management. There are various payment rules which can be implemented in the scheme including[47]:

- A single payment after default is validated
- A single payment after legal actions are initiated

[47] Rocha et al., 2010

- Partial payment at the time of default, followed by the remaining payment when judicial procedures are exhausted
- Single payment when judicial procedures are exhausted

In 66%[48] of the schemes globally, the banks are responsible for the recovery of the defaulting loans, with 34% of the scheme pay-outs made after the borrower defaults.

It is important that the decision around the payment rule should be made in conjunction with the efficiency of the country's judicial system. In countries where the judicial system is efficient the bank can afford to accept the proviso that they will be paid out once all legal avenues have been exhausted. This is however unlikely to be the case in countries where the judicial system is inefficient, in which case the process would be too long and drawn out, leading to losses to the lenders and limiting the attractiveness of a PCG. Table 6 shows the number of years legal settlement of a loan normally takes and the respective recovery rates for different countries.

Table 6: Recovery Rates and Duration

Country	Recovery Rate (%)	Duration (years)
Canada	88.7	0.8
Chile	21.3	4.5
Colombia	35.3	1.7
France	44.7	1.9
Hungary	38.4	2.0
India	15.0	7.0
Korea	80.5	1.5
Malaysia	38.6	2.3
Netherlands	82.7	1.1
Romania	28.5	3.3
Taiwan, China	80.9	1.9
USA	76.7	1.5
Egypt	16.8	4.2
Jordan	27.3	4.3
Lebanon	19.0	4.0
Morocco	35.1	1.8
Saudi Arabia	37.5	1.5
Syria	29.5	4.1
Tunisia	52.3	1.3
UAE	10.2	5.1

Source: Rocha et al., 2010

Collateral and down payment

One of the recognized benefits of a PCG is that it reduces the risk associated with a bank providing a loan; in essence compensating the bank in the instance when there is a lack of

[48] Beck et al., 2008

100% collateral coverage. As the levels of collateral decrease, the levels of risk associated with adverse selection and moral hazard increase. In these situations the schemes will look to enforce rules around collateral cover levels or down payment options. Various examples of different collateral requirements are highlighted in Table 7.

Table 7: Collateral and Down Payment Examples

Country	Down-payment	Collateral
Egypt	Medium firms: 20%	Allowed, no ceiling on the level of collateral required by the banks (maximum)
Jordan	30% SME loan 30% industrial loan 50% leasing	Allowed, no ceiling on the level of collateral required by the banks (maximum)
Lebanon	20% of total investment 30% if start-ups	Allowed, Ceiling of 50% of the loan amount
Morocco	Start-up loans: 10%-20% depending on the loan amount	Allowed, Ceiling of 100% of the loan amount
Palestine	No	Allowed, no ceiling (in practice, the majority of loans are not secured against collateral)
Tunisia	30% of the cost of the investment	Allowed, no ceiling
Saudi Arabia	No	Allowed, no ceiling

Source: Rocha et al., 2010

Operational Mechanisms

The analysis of the loan and the associated credit risk under normal loan conditions is handled by the bank offering the facility. In the case where a PCG is involved, the assessment procedures may include the scheme's evaluators. Essentially there are three models for delivering the guarantees, which are outlined in Table 8.

Table 8: Operational Mechanism Types

Model	Definition
Individual	Every loan application is assessed and approved by the guarantee scheme
Portfolio	A more flexible approach which allows the banks to extend guarantees without consulting the scheme
Hybrid	A mixture of elements of the individual and the portfolio approaches i.e. certified lenders may be allowed to extend guarantees without referring to the scheme up to a limit, after which it has to adopt the individual approach to appraisal.

Source: Rocha et al., 2010

The paper by Beck *et al.* (2008) suggests that globally, the majority of the schemes use the individual approach with the minority utilising the hybrid.

Table 9: Country Adoption of Operational Mechanisms

Country	Operational Mechanism
Canada	Portfolio
Chile	Portfolio
Colombia	Hybrid
France	Hybrid
Hungary	Hybrid
India	Portfolio
Korea	Hybrid
Malaysia	Hybrid
Netherlands	Portfolio
Romania	Hybrid
Taiwan, China	Hybrid
USA	Hybrid
Egypt	Individual
Jordan	Individual
Lebanon	Individual
Morocco	Hybrid
Palestine	Individual
Saudi Arabia	Individual
Syria	Individual
Tunisia	Individual
UAE	Individual

Source: Rocha et al., 2010

Credit risk management

Well established guarantee schemes around the world have developed internal credit scoring systems and also rely intensively on information provided by credit bureaus and registries. In some countries such as Malaysia and Korea, guarantee schemes have developed their own SME credit bureaus. Some guarantee schemes have also provided assistance to banks in SME risk analysis and management. Guarantee schemes can share banks expertise and disseminate their methodologies and credit scoring models.

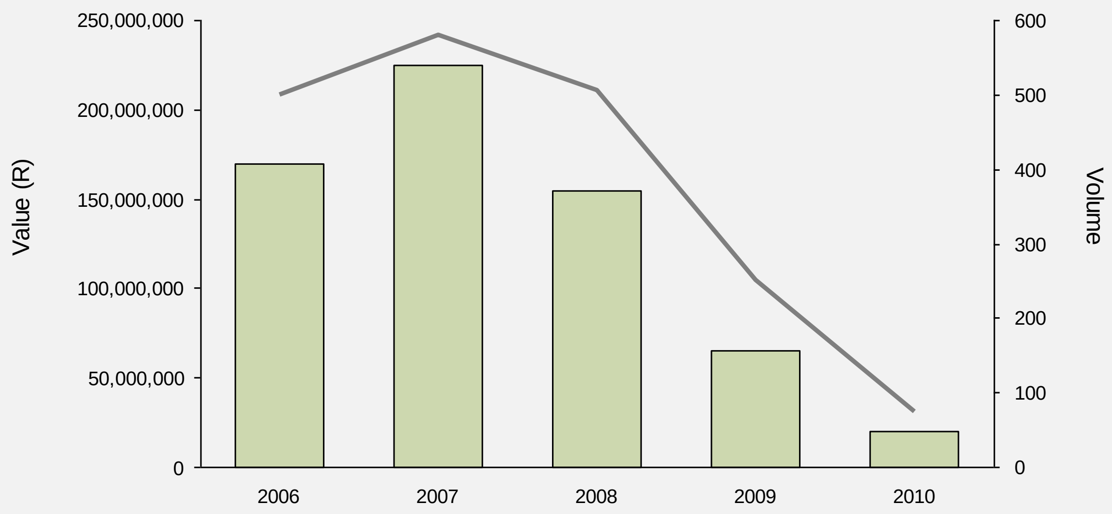
It should however be noted that schemes with their own credit scoring systems need to be wary of duplicating efforts. Commercial banks with experience in lending have well established and robust credit risk management capabilities. For a scheme to second guess every position a bank takes may not be useful to the process, as was discovered with Khula in South Africa.

Box 6: Case Study – Khula (South Africa)

Khula is normally the lead parastatal in the area of SME lending in South Africa, with a mandate to provide financing to the SME market through intermediaries as a wholesale financier. Khula's two principal products for SME financing are Khula Credit Indemnity Scheme and Non-Bank Retail Financial Intermediaries (RFIs). The purpose of the indemnity scheme is to share risk with commercial banks through a PCG. Finance is approved directly by the bank, which can apply to Khula for a guarantee when there is inadequate collateral of coverage up to 90%.

It is generally recognized that Khula has not been a success, which is highlighted by the reduction in new indemnities (both value and volume), as shown in Figure 5:

Figure 5: New Indemnity Applications



The reasons cited for the poor performance of late include:

- The conditional pay-outs by Khula only proceed when the financial institutions have exhausted all recoveries of collateral – typically the process takes over a year
- The extremely strict eligibility criteria
- A dual credit assessment process whereby the financial institutions and Khula both assess the borrower, banks found that this took so long, that the customer's demand for the loan could disappear

Source: World Bank, 2011a

Summary of best practice in designing/implementing PCGs

The success of a PCG scheme is deemed to be closely correlated to country specific characteristics. There are however important key success factors for each of the pillars, highlighted by the cross-country comparisons.

The eligibility criteria should be closely aligned with the specific goals and mandate of the scheme; equally there is a consensus internationally that the focus should be on the firm size (categorized by turnover or asset value) and not necessarily by industry (unless clearly stipulated in the mandate, for example where a country may want to specifically develop their agricultural sector). Best practice suggests that the scheme should not specify the type of product or the age of the business (to encourage the provision of working capital and support for start-ups)[49].

Getting the coverage ratio correct is a fine balancing act, as not covering the loan adequately could lead to limited take up, while excess coverage could potentially result in moral hazard (lending to a too risky client base) for the financial institution. A median level internationally is approximately 70%, with lower levels for less risky deals, and higher levels when it is required. Equally, the fee structure needs to prevent moral hazard and should play a role in the sustainability of the scheme, but not deter the use of the guarantee.

Collateral requirements are a key issue for the MSME sector. The rules governing the collateral coverage that participating institutions should seek from their clients will determine which MSMEs benefit from a PCG. If the scheme specifies high levels of collateralization, then banks will principally use the scheme as a way of minimizing their loss given default, thus improving the profitability of lending, more than changing the risk profile of the borrower. If the scheme does not specify any level of collateralization, the banks could use it as an opportunity to provide loans to those MSMEs which would normally not qualify for a loan as they lack collateral, therefore ensuring 'additionality'.

It is important for the scheme's operational mandate to be consistent with its intended segment focus. A portfolio approach is applicable for micro enterprises where the volume of loans tends to be high, whereas an individual approach would suffice for medium enterprises where a lower volume of larger value loans are the norm.

Essential to the sustainability of the scheme is its reputation in timely pay out to the financial institutions in the case of a default. The scheme should avoid duplicating risk assessment processes and monitoring exercises and promote efficiency with regard to processing claims. A financial institution must have a reasonable certainty that the guarantee will be quickly honoured if it is to have any impact on their credit decision process.

Internationally, PCGs have proven to be an effective intervention mechanism for increasing access to finance for MSMEs as they directly target the biggest constraint for financial institutions when lending to this market, namely poor collateral. Given the complexity around the design of these schemes, close attention needs to be given to market conditions specific to a country, and how they affect the credit decision process for the financial institutions.

5.1.4. STATE BANKS

State-owned institutions, including commercial banks, development banks and specialized SME finance institutions have been widely used around the world in order to serve and develop their respective SME markets. The main justification for the presence of state owned financial institutions is that private institutions are unwilling to service certain segments of the population due to the perceived risks and/or costs involved[50].

The success of such interventions and the performance of such institutions is very mixed. Rather than review all the literature on the performance of state owned financial institutions,

---

[49] Rocha et al., 2010
[50] Rudolph, 2010

our particular focus is on their effectiveness in addressing the needs of MSMEs. In this regard there are two major criticisms of state-sponsored institutions that serve the MSME sector.

The first issue relates to distribution: to reach a significant number of MSMEs, institutions need a considerable network of branches and/or offices. Whereas large state-owned commercial banks can often support large branch networks this is far less often the case with development finance institutions. This has implications for the type of business that the different institutions can effectively serve - development finance institutions are best at meeting the needs of larger firms (which may be targeted for other developmental reasons) and are generally ineffective at serving the MSME sector. On the other hand, state-owned commercial banks often get tasked with a very wide range of development mandates making it difficult for them and their shareholders to clearly define their mandate with respect to lending to MSMEs.

The second concerns the quality of risk management. The literature highlights that state institutions, on average, have weaker risk management systems[51].

This leads into the most important issue with respect to the design and management of state owned financial institutions; which is to achieve clarity in mission and purpose and to ensure that this is translated into a clear set of management metrics. This ensures that the state’s support is channelled in the manner intended in the institution’s mandate. State owned financial institutions involved in the provision of services to MSMEs need to clearly define what “market failure” they are addressing and how this is embedded in their organization; from product design through to performance targets. Thus if the organization is set up to take more risk than its competitors in the private sector, it is important to ensure that it does indeed take more risk, prices for this risk, and only accept debt of a defined credit grade, and that the level of losses that result are factored into shareholders expectations. Too often risk management standards and pricing strategy is too loosely defined resulting in the state owned institution drifting between competing with private companies and/or accepting unsustainable levels of risk.

In many instances, state-owned institutions destroy value for their Government sponsor by offering lower rates of return on their equity as a result of lower levels of efficiency, rather than through accepting different kinds of risk. Thus the more successful cases usually involve legislation specifying clear mandates, establishing sound governance structures with independent boards, and imposing clear performance criteria. In some cases, specific legislation or board directives stress that the bank will not compete directly with the private sector but will fill gaps and target the segments that remain underserved.

A further constraint to the effective functioning of state owned finance institutions is that they often require considerable capital support from Government if they are to have a real impact. If sufficient support is not forthcoming then credit rationing results, and in such an environment the allocation of credit can become politicized.

It is for these reasons that many Governments now focus on increasing the supply of credit to MSMEs by supporting a change in risk appetite of private institutions through instruments such as PCGs rather than incur the cost and responsibility of creating institutions to undertake direct state provision, especially when small or micro enterprises are to be targeted.

[51] Rocha et al., 2010

Box 7: Case Study - Banco Estado (Chile)

Banco Estado (the Chilean State Bank) targets SMEs and segments of the population not generally served by commercial banks. The Chilean government supported Banco Estado in its early years, but later promoted an autonomous and independent management of the bank.

Under strict control of the risk parameters, Banco Estado increased its market share in lending from 13% to 16%, between December 2008 and November 2009. Another decision that proved to be material was an anticipated reduction of the foreign exchange net position of the bank to levels close to zero. The sound financial position of bank at the beginning of the crisis and the timely capitalization of the bank (USD 500 million or N 77.5 billion) were essential for applying countercyclical financial policy.

Source: IFC, 2011a

5.1.5. APEXES AND WHOLESALE FUNDING

Wholesale facilities, or apexes, are set-up to manage and on-lend funds to financial institutions, to improve their liquidity and reduce their cost of funding so that they can expand access to finance. Apex institutions have played a critical role in scaling-up microfinance and small enterprise finance in a number of countries. There are at least 76 apexes globally; with their main funding instrument being in local currency debt. They are mostly funded by governments and/or international donors[52].

Apexes have been effective where they have set high performance standards for their financing to financial institutions, thus focusing investment on financial institutions which have the capacity to build large-scale, financially viable operations:

In a review of Apex facilities globally, CGAP found that[53]:

- Apexes have tended to be too optimistic in assessing the number of financial institutions that will qualify for funding.
- Apex facilities may need to provide technical assistance and training to qualifying financial institutions, in order to increase their absorption capacity, growth potential and financial sustainability. However, grants for technical assistance represent a very small percentage of overall apex funding.
- Financing should be sufficiently flexible so as to fit each financial institution's cash-flow needs, institutional capacity and past performance.
- Apex boards must be sufficiently protected or independent from political influence.
- When well-managed, apexes can attract commercial investment for financial institutions by demonstrating their repayment capacity at commercial interest rates.
- Funding from apexes can prove useful in times of international liquidity squeeze as was the case during the global crisis.

[52] Isern, 2009
[53] Isern, 2009

Box 8: Case Study - South Asia Regional Apex (SARA) Fund (India)

South Asian Regional Apex Fund (SARA), launched in 1995, is a USD 25 million fund primarily focused on growth investments in small to medium-sized enterprises engaged in technology, manufacturing, media and retailing.

While the Fund was originally conceived with a development orientation, and had a specific focus on smaller developments in early stage companies, but later the focus was diversified (in terms of larger and more mature companies) and since mid-1998, SARA has invested across technology, media, distribution, biotechnology and telecommunications. SARA has invested in 26 companies and is fully committed. The Fund has exited from 19 of its investments, generating a gross return of 15% for its contributors.

Source: IFC, 2011a

Wholesale funding made available by a public institutions (such as an Apex facility) to be lent on through the financial sector will generally only be successful if the targeted financial institutions are experiencing liquidity constrains. Commercial banks are generally under leveraged in developing African countries and therefore are not actively searching for funds which are often more expensive (unless the rates or terms are favourable) than they can source through their normal deposits. Smaller institutions such as second tier banks or MFIs, on the other hand, are more willing to pay for wholesale funding from Apex facilities, if they are not legally allowed to collect deposits, or do not have the required scale or risk rating to attract funding from the private sector.

5.1.6. SUPPLY SIDE CAPACITY BUILDING

Financial institutions whose main business line is not the MSME sector (those with a heritage of servicing upper retail segments and corporate banking), often have a weak institutional capacity for providing financial services to this sector. These institutions therefore need to proactively acquire the prerequisite learnings and capabilities. Government interventions that reduce the cost of learning for an institution can change the business case for entering the MSME sector.

The capacity building initiatives generally come in the form of a grant which is provided by the government or some donor organization, to be spent by the financial institution on a prescribed list of activities that could include the purchase of technical assistance, development of new technology, risk methodologies, market research, etc.

Best practice suggests that the grant be divided into phases, and disbursed after clear objectives have been achieved in each phase. These objectives need to be clearly monitored and assessed by the entity providing the grant. Successfully meeting the objectives will lead to the next phase with more funding. The end goal for the intervention is to achieve a sustainable operation for the financial institution with which to continue operating in the respective segment.

Box 9: Case Study - IFC's Financial Markets Technical Assistance (FMTA) Activities

IFC's FMTA activities are organized under three global themes, or programs:

- *Institution Building* for mainstream financial institutions such as banks. Projects address core banking operations (credit, asset-liability management, corporate governance). Most projects are institution-specific and linked to an IFC investment, but some are stand-alone and some provide broad-based training to the banking industry.

- *Diversifying Financial Services* to support new, nonbank financial services, such as leasing, housing finance, securities markets, insurance, and pensions. This program includes feasibility studies, helping to create enabling business environments, and institution building for specific financial institutions.

- *Providing Finance for SMEs* has three components: institution building to create profitable SME financiers (that is, supporting IFC investments); strengthening the ability of local training institutes to provide bank training; and developing partnerships with best practice practitioners and providers to replicate successful models worldwide.

Source: IFC, 2002

A successful capacity building initiative will lower the risks associated with the lending, by improving the institution's capabilities in the required operational areas. However, to be effective in enhancing financial inclusion as an initiative, it is important that the financial institutions that receive the grant eventually commit to large scale roll out.

5.1.7. ENCOURAGING INNOVATION

Innovative financial inclusion suggests improving access to financial services for MSMEs through the development and scaling of new approaches. Donors and governments are increasingly investing in Challenge or Innovation Funds that provide grants to financial institutions that are seeking to design or implement new approaches to financial inclusion. Grants differ from loans in that they don't require repayment of capital or interest. Grants should only be administered where the applicant will not qualify for a loan but has a worthwhile innovative project.

Innovation/Challenge Funds

A challenge fund provides time-bound grant assistance to the private sector, sharing short-term market risk with them. Challenge funds leverage investment by the businesses, of at least an equivalent amount, and often much more. The supported ventures are selected through open competition in terms of their potential for impacting large numbers of the financially excluded both directly and through demonstration to other firms. The grants enable new business models to be developed that may otherwise not be pursued at all or may only receive marginal attention by the private sector. Only upfront grants are required, as the business is expected to be commercially sustainable thereafter, once the grant is factored in. The strength of a challenge fund lies in its ability to be focused, entrepreneurial, opportunistic and cost-effective, i.e. to function as a temporary market development catalyst. At its best, a challenge fund will stimulate private sector investment and risk-taking to discover new ways of working in areas and market segments where the costs and risks are unknown, and where the pro-poor impact may be significantly larger than with conventional business processes.

DFID's Financial Deepening Challenge Fund (2000 – 2009) promoted private-sector efforts to develop commercially viable financial services that benefit the poor and promote economic growth. USAID's Office of Microenterprise Development has two programs - the Implementation Grant Program and the Practitioner Learning Program - focused on innovations that improve the effectiveness and efficiency of financial service and enterprise development programs for the poor. Both programs incorporate a thematic focus and explicit learning components. Another programme is CGAP's Pro-Poor Innovation Challenge award program, which is directed at microfinance institutions but could be equally applied to SME finance institutions.

Box 10: Case Study - Shared Growth Challenge Fund (SGCF)

The SGCF was conceived as an enterprise challenge fund in 2009 as a path-finding initiative. Its goal was to enhance the impact that the private sector can make to the sustainable reduction of poverty in South Africa. The high-level goal of the SGCF was to contribute to poverty reduction in South Africa by means of the deployment of a credible and effective challenge fund instrument. The Business Trust allocated ZAR 45 million (N 930 million[54]) to the project over a period of two years. Of this, ZAR 35.5 million (N 735 million) was set aside for grant making activities, with the remainder allocated to the design and management of the program.

In total, 21 applications were submitted to the fund managers. The Investment Committee approved 11 projects. Although not all projects reported on job creation (as this was not always the primary aim of the project), the fund management team endeavoured to collect this information where available. Through the application of sectoral multipliers, the following impressive figures can be taken as indicative values for the program as a whole:

- Direct jobs: 916
- Indirect jobs: 2,203

Source: IFC, 2011a

Prizes versus Grants

A very different approach is the use of prize money. A prize is only paid if a specific result is achieved. This may be useful when the objectives are clear but the ways to achieve them are not.

Box 11: Case Study - Prizes to Drive Financial Innovation in Haiti

The Bill & Melinda Gates Foundation and USAID offered a USD 10 million (N 1.55 billion) prize to spur the development of mobile banking in Haiti after the earthquake in 2010. The MNO Digicel won the first USD 2.5 million for being the first provider to launch m-banking services. The second operator to launch will receive USD 1.5 million. To ensure that the services being built are scalable and sustainable, another USD 6 million will be awarded when the first 5 million transactions take place, divided accordingly among those that contributed to the total number of transactions.

It is too early to predict whether this prize money has helped bring about sustainable mobile money services in Haiti. However, it was a creative attempt to introduce more competition and tie funds to results achieved.

Source: IFC, 2011a

[54] An exchange rate of ZAR (South African Rand) 1 to N (Naira) 20.7 was used in the conversions

Social Impact Bonds

A more recent form of innovation comes in the form of Social Impact Bonds, or an outcomes-based contract in which government commits to pay returns for an initiative such as financial inclusion, sometimes also known as 'Pay for success' projects. Through a Social Impact Bond, private investment is used to pay for interventions, which are delivered by service providers with a proven track record. Financial returns to investors are made by the public sector on the basis of meeting certain outcomes or objectives. Social Impact Bonds provide up front funding for prevention and early intervention services, and remove the risk that interventions do not deliver outcomes from the public sector. The public sector pays if (and only if) the intervention is successful. In this way, Social Impact Bonds enable a re-allocation of risk between the two sectors.

Benefits of Social Impact Bonds include[55]:

- The public sector only has to pay for effective services; the third party private investor bears all the risk of services being potentially ineffective.
- Investors and service providers have an incentive to be as effective as possible, because the larger the impact they have on the outcome, the larger the repayment they will receive.
- The Social Impact Bond approach embeds vigorous on-going evaluation of program impacts into operations, accelerating the rate of learning about which approaches work and which do not.

Box 12: Reduction in Re-offenders Amongst Male Prisoners (UK)

After receiving investment support from Impetus Trust, St Giles Trust, a charity which provides access to housing, training and jobs for ex-offenders, teamed up with Social Finance, a UK based institution which designs financial structures to create the first Social Impact Bond. The Bond was launched in 2010, and has been designed to reduce re-offending amongst male prisoners leaving HMP Peterborough who have served a sentence of less than 12 months.

Social Finance raised GBP 5 million from 17 social investors to fund this work, which is new money into the sector. The investors are mostly charitable trusts and foundations, some of which are the giving vehicles of high net worth individuals or private banks.

If the initiative were to reduce re-offending by 7.5%, or more, investors will receive a share of the long term savings to the Government from the Ministry of Justice. If the Social Impact Bond delivers a drop in re-offending beyond this threshold, investors will receive an increasing return the greater the success at achieving the social outcome, up to a maximum of 13%. However, if reoffending isn't reduced by at least 7.5% the investors will receive no recompense at all. Returns are to be decided by comparing the number of reconvictions for the One Service cohort compared to a similar group of short sentenced male prisoners across the UK. The scheme is currently in its second year of operation (out of 6), and a judgment on success can only be made after year 4. It is however showing positive results so far.

Source: Social Finance, 2011a

Challenge Funds, Prizes and Social Impact Bonds are examples of attempts by government to create institutions that channel support for social innovation to financial institutions in a cost

[55] Social Finance, 2011a

effective manner that limits the need for government to pick winners, and may therefore be effective in environments of weak public sector integrity or limited capacity.

5.2. ASSESSMENT OF THE INTERVENTIONS

In this section a summary and comparison of how the different interventions are likely to perform is presented based on the following three dimensions:

- Their ability to affect the credit decision process at a financial institution
- The costs of the scheme to the public sector in relation to its effectiveness
- The sub segment focus / relevance of the scheme

These dimensions are described in more detail below, followed by a comparative assessment of the different interventions.

5.2.1. ASSESSMENT CRITERIA

Effects on the Credit Decision Process

The success of public interventions that seek to leverage the private sector will be dependent on their ability to influence the credit decision process at the financial institution. A financial institution's decision to lend will depend on whether the intervention affects at least one of three key dimensions: the overall revenue potential for the loan, the cost implications of making the loan and lastly the risk associated with the loan, which in turn affects the previous two criteria (illustrated in Figure 6).

Figure 6: Credit Decision Process Dimensions

Source: Genesis Analytics Team Analysis, 2012

- Expected revenue

Before providing finance to a borrower, a financial institution will assess an application on its revenue potential which ultimately feeds into a profit calculation. The institution will have a predetermined profit margin level in mind and therefore the revenue potential has to meet the minimum margin requirements (after taking the costs into account). In order to increase the level of lending to a segment an intervention should increase the revenue derived from making a loan.

- Expected costs

The other aspects of the profit calculation are the costs involved in processing and monitoring a loan. Interventions which are able to lower the institution's cost structure stand a good chance of impacting the credit decision in a positive way.

- Risks involved

Interventions focus directly on reducing the riskiness of lending, either by reducing the loss if there is a default, or the likelihood of default.

For any intervention initiated by a public entity to succeed, the outcome needs to focus on at least one of these 'credit decision process' dimensions. In the sections below, the various internationally accepted interventions and an assessment of which of the dimensions are targeted in each case, are discussed. Table 10 assesses the current internationally accepted interventions.

Table 10: Effects on the Credit Decision Process

Intervention	Effect on credit decisioning			Comment
	Revenue	Costs	Risk	
General Regulatory Environment				
• Interest rate caps	✗	-	-	This regulation has a negative effect on potential for interest revenues for an institution
• Directed lending	-	-	✗	Forcing a line of lending negatively affects the risk appetite for a financial institution
Partial Credit Guarantees	-	-	✓	PCG schemes are an effective way to reduce the risk in lending by guaranteeing that a portion of the capital will be repaid
State banks and donor organisations	-	-	-	These institutions do not directly affect the decisioning process of private institutions but may crowd out private lending
Apex and wholesale funding	-	✓	-	Wholesale funds tend to decrease the costs of lending by offering cheap funds to lend on
Supply side capacity building	-	✓½	✓	Technical assistance provides guidance on risk reducing initiatives and processes when lending
Enabling environment				
• ID/KYC	-	✓	✓	Any form of identification reduces risks and costs for an organization
• Courts	-	-	✓	Courts improve legal infrastructures which in turn reduce risks around property ownership etc.
• Credit Bureaus	-	✓	✓	Provides information on the creditworthiness of borrowers – lessens the chances of lending to a bad customer
• Registries	-	✓	✓	Ensures that collateral is only being linked with lending once – ensures and reduces the risks and costs
Innovation funds	-	✓	-	Reduces the chances of institutions losing money to innovative ideas where grants are better suited

Scale	Positive effect: ✓	Semi-positive effect: ✓½	No effect: -	Negative effect: ✗

Source: Genesis Analytics Team Analysis, 2012

A successful intervention aims to alter the credit decision process in a positive way for the lending institution. There are however examples of interventions such as certain regulatory initiatives (interest rate caps and directed lending) that essentially negatively affect the process. Imposing a maximum level of interest at which an institution is allowed to lend, limits the level of revenue that a bank can expect to make for a transaction. Similarly, forcing a bank to lend to a particular type of customer that it normally may not be comfortable engaging with (usually due to high levels of risk) negatively affects the risk dimension of the decision process.

Other interventions (as outlined in the table above) which affect the decision positively can be conveniently categorized across the three categories: risk, revenue and cost. PCGs are effective at changing the risk profile of a loan for the financial institution. Ensuring that in the case of a default, the lending institution will receive its capital back, thereby lowering the risk of loss due to default for that institution. The end result of this scheme is that the lender is more willing to provide loans to riskier borrowers. Similarly, capacity building (supply side) initiatives reduce the risk for the lender through technical assistance enhancing the bank's lending and risk assessment capabilities. Being able to make better informed decisions has a positive effect on profits by minimizing the costs associated with defaults. Initiatives which focus on enabling the financing environment, generally help to lower the associated risks. By providing institutions, such as credit bureaus and registries, a degree of confidence is provided to the financial institutions when lending.

Wholesale funding provided to financial institutions to lend on to the market, is an example of an intervention which has the potential to affect the cost aspect of the credit decision process (by offering wholesale funds at a discounted rate). Capacity building and enabling environment initiatives are also capable of reducing costs through efficiencies gained operationally, i.e. through capabilities learned through the technical assistance, and ID system, credit bureaus and registries simplifying the information gathering process.

State-owned banks and similar lending donor organizations are examples of an intervention which do not directly affect the credit decision process of existing financial institutions as they provide services directly to the public rather than providing incentives to the financial institutions.

Cost / effectiveness of the scheme

The effectiveness of the various interventions can be assessed according to the complexity, capital/funding requirements, levels of sustainability and the costs required to achieve scale.

These criteria must be closely aligned to the goals of the interventions and take specific characteristics relevant to MSMEs into account.

- **Complexity**

The complexity of an initiative relates to the amount of effort that is required in the design and execution of the scheme on the part of the implementing entity. It also assesses the initiative on its intuitive nature and how easily accessible it is to the participating institutions. The more complex an initiative is, the less likely it will be successful in its implementation.

- **Capital / funding required**

The cost of initiating/running an intervention directly affects the business case for implementation. A large, fund-intensive initiative would require significant buy-in by different stakeholders just to get up and running; and depending on the financial circumstances experienced by the investing entity, may not be feasible. Less expensive schemes may be a more acceptable use of limited public resources.

- **Sustainability**

The sustainability criterion assesses the initiative on its ability to remain relevant and effective. This can be based on supply and demand dimensions i.e. whether it is self-sustainable or whether it needs outside support in terms of funding (supply), and whether it has the ability to remain relevant in the market (demand). The easier it is to sustain an initiative, the more likely it is to be implemented and successful.

- **Ability / costs to achieve scale**

The scheme's ability to achieve scale is directly linked to the specific target market's characteristics. In this case, the Nigerian market constitutes the various MSME sectors, and with estimates of between 10 and 50 million enterprises it can be considered a voluminous market. Given the number of potential beneficiaries, a scheme should only be implemented if it has the potential to reach a significant number of companies in the target market. This is important from the perspective of fairness and efficiency. Being able to achieve scale is imperative for a scheme to be worthwhile, especially in the Nigerian context. While achieving scale is a critical aspect, this must be judged against the cost of reaching scale. Table 11 assesses these various criteria for the different interventions.

Table 11: Cost / Effectiveness of the scheme

Intervention	Cost/Effectiveness of the scheme				Comment
	Complexity	Capital/funding required	Sustainability	Ability/costs to achieve scale	
Partial Credit Guarantees	◑	◑	◕	◕	PCGs are complex and expensive initiatives to design and implement, but if done correctly can be extremely effective
State banks and donor organisations	○	○	◔	◔	Are extremely expensive and complex to manage, generally have a poor performance and effectiveness record, and often have a limited ability to reach any scale if involved in direct lending
Apex and wholesale funding	◑	○	◔	◕	While relatively expensive to initiate and sustain, wholesale funding initiatives are less complex than PCGs
Supply side capacity building	●	◕	◔	◑	Technical assistance is relatively inexpensive and easy to implement. Reaching scale can prove difficult
Enabling environment					
• ID/KYC	○	◔	●	●	A national ID system is extremely hard to implement
• Courts	◑	◑	◑	◑	A functioning legal system is a pre-requisite
• Credit Bureaus	◕	●	●	◕	Credit bureaus can be run by private companies
• Registries	◕	●	●	◕	Not particularly expensive or complex to run and maintain
Innovation funds	●	◔	◔	◑	Innovation funds are easy to run and design and provide positive externalities in the form of public goods (through promoting innovation)

Scale	Very complex/costly/unsustainable/unable to reach scale ○	Very simple/low-cost/sustainable/scaleable ●

Source: Genesis Analytics Team Analysis, 2012

Large scale interventions such as PCGs, state-owned banks and wholesale funding are generally complex entities with numerous rules and design components which are intricately entwined. It is clear that credit guarantee funds will be less costly to design and easier to manage than creating entire financial institutions for a specific cause. They are also preferable to the provision of lines of credit as they are cheaper to implement, and typically address the principal challenge which is the lack of collateral. From a bank's perspective, while funding is always fungible, it is extremely difficult to determine whether lines of credit are used for the purpose intended, and whether there is 'additionality' in lending.

The ability for any scheme to achieve scale is an important factor in determining its overall effectiveness in the market. Unless Government's can commit sufficient resources for the intervention to have a significant impact on the market, while at the same time managing the criteria of the intervention to ensure sustainability, alternative approaches may prevail. Regulation on the other hand is all encompassing and due to its directive nature, reaches the whole market.

Segment Impact

The MSME sector is extremely diverse. The different segments captured in this group (micro, small and medium) have varying needs, ranging from their legal status to their perceived riskiness and the financial support they require. In their design, initiatives may be better geared at servicing certain segments rather than the whole sector. Understanding when a certain initiative is suitable for a specific segment is an important policy consideration as shown in Table 12, and discussed thereafter.

Table 12: Segment Impact

Intervention	Segment Impact			Comment
	Micro	Small	Medium	
General Regulatory Environment				
• Interest rate caps	H	H	M	Interest rate caps will affect the micro and small segments the most, as due to their level of risks, banks would look to charge higher rates. If they are restricted from doing this they will not lend
• Directed lending	H	H	M	Again the riskiest segments (micro and small) will be the worst affected by forcing banks to lend in a certain sector they are not comfortable lending to. In this instance they will look for the leas risky business, i.e. the medium enterprises
Partial Credit Guarantees	L	H	H	Due to the scale of the different sectors, PCGs operationally are better suited to bigger value smaller volume transactions, and therefore will have more of an impact in the medium and small segments of the market
State banks and donor organisations	L	L	M	State-owned financial institutions, due to their distribution capabilities and risk acceptance criteria are better suited for lending to medium (larger) enterprises
Apex and wholesale funding	H	M	L	Conventional institutions (commercial banks) who are more likely to lend to the larger enterprises are not liquidity constrained and therefore will generally overlook wholesale funding options. Small microfinance orientated institutions are more likely to take advantage of this form of initiative
Supply side capacity building	M	M	L	Institutions targeting the micro and small segments are more likely to require and in turn adopt capacity building (technical assistance) exercises
Enabling environment				
• ID/KYC	H	M	L	More impact will be realized where less information is known about the customer
• Courts	L	M	H	Courts will be more prominent where larger disputes take place, i.e. in the medium segments
• Credit Bureaus	L	H	M	Volumes limit the effectiveness of credit bureaus, and therefore the micro segments may be excluded
• Registries	L	M	H	Impact will lie in segments where collateral is an option, i.e. in the larger enterprises
Innovation funds	M	H	L	Because grants are designed to be issued to institutions who do not qualify for loans, smaller institutions are more likely to benefit from them.

Scale	Low: L Medium: M High: H

Source: Genesis Analytics Team Analysis, 2012

The micro enterprise segment is best targeted by interventions which are able to handle large volumes. While risk, due to a lack of information, is the main constraint to credit in this segment, interventions that focus on collateral such as PCG's have little relevance. Wholesale funding to the institutions that serve this segment may be a more effective intervention as the institutions focusing on this segment are generally funding constrained (unlike the larger universal banks – which have sufficient cheap funds to lend out but don't focus on the micro segment) and are willing to pay a little extra for access to these funds.

Small enterprises are positively impacted by most of the initiatives available in the market including: PCGs, wholesale funding, capacity building initiatives, enabling environment initiatives and various schemes which are classified as innovation funds.

Many of the initiatives which favour lower volume and larger value transactions are suitable for promoting the 'larger' medium enterprises. PCGs and various enabling environment initiatives (such as Credit Bureaus and registries) are good examples of this. It is unclear, however, whether the extent to which medium enterprises are financially constrained is due to being deemed risky by the financial institutions or not. If risk levels are not the reasons why banks are not lending to this segment, focus needs to change to initiatives which change the cost or revenue equations for the financial institutions.

6. SUPPLY SIDE INTERVENTION IN NIGERIA

In this section the public initiatives that support access to credit for MSMEs in Nigeria are reviewed.

6.1. REGULATORY ENVIRONMENT

6.1.1. NATIONAL POLICY ON MSMEs

This policy was formulated by The Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) and The United Nations Development Project (UNDP) and launched in 2007, with a view to creating a supportive environment for MSMEs in Nigeria. The policy incorporates 7 broad programme areas which are:

1. Institutional, legal and regulatory framework
2. Human resource development
3. Technology, research and development
4. Extension and support services
5. Marketing
6. Infrastructure
7. Finance

For each programme area, the policy defines objectives and strategies to achieve the objectives and "actionable steps and tasks" and the time frame in which these were to be completed (ranging from short term which is less than 12 months to long term which is longer than 24 months).[56]

Within the original policy, MSMEs are defined as shown in Table 13 below (with employment criteria taking precedence if there is any conflict between assets owned and number of employees). [57]

Table 13: Definition of MSMEs

	Assets (excluding land and buildings)	Employees
Micro	Less than N 5 million (USD 32 000)	Less than 10
Small	N 5 million – N 50 million (USD 32 000-USD322 000)	10-49
Medium	N 50 million – N 500 million (USD 322 000 – USD 3.2 million)	50-199

Source: Federal Republic of Nigeria, undated

[56] Federal Republic of Nigeria, undated.
[57] Federal Republic of Nigeria, undated.

This definition is currently being revised[58] and the outcome is important for a number of reasons. Firstly, given that the public initiatives and incentives are designed to boost access to credit for MSMEs, it is important that all market participants and stakeholders are working from a standard definition. Otherwise, eligibility criteria across banks and public interventions will not be standardized which can distort incentives and progress measurement. Despite having set out clear definitions, many public institutions and policy pronouncements use the definitions loosely, often implying that an intervention will meet the needs of the micro enterprises when in reality the beneficiaries are small and medium enterprises.

Furthermore, given that financial institutions inherently want to reduce their risk and tend to observe an inverse relationship between size of firm and credit riskiness, financial institutions will be inclined to target the upper end of the size bracket if they can. As such, it is important not to create definitions which are too broad. In particular, increasing the turnover or employment criteria for the micro segment could allow institutions to claim they are servicing the micro segment when in fact they are servicing the small enterprise segment and inappropriately access public support initiatives designed to meet the needs of the micro segment.

As 5 years have passed since the launch of the policy, a revision would be recommended, including an assessment of progress in achieving the objectives and perhaps a revision of the objectives to reflect the current state of the industry.

6.1.2. REVISED MICROFINANCE POLICY, REGULATORY AND SUPERVISORY FRAMEWORK FOR NIGERIA, 2011[59]

In Nigeria, 90% of MSMES are informal micro enterprises that are most effectively served by MFBs.[60] As a consequence of this, the regulators have sought to achieve an enabling environment for the growth of MFB operations in Nigeria.

In December 2005, the CBN introduced the Microfinance Policy Framework that was intended to enhance financial access for micro-entrepreneurs and low income households. Microfinance is herein defined as loans, deposits, insurance, fund transfers and other ancillary non-financial products that target low income clients (in line with the CBN definition)[61]. In April 2011 the CBN published the revised version of this document.

The targets of the 2011 Microfinance Policy are to:

1. Increase access to finance services for the economically active poor by 10% per year.

---

[58] After discussions with SMEDAN in the interview conducted by Genesis Analytics and EFInA in January 2012 it was apparent that significant work has already been conducted on the MSME definition revision, although this information has not yet been made public
[59] Federal Republic of Nigeria et al., 2011
[60] IFC, 2010 – it must be noted that these numbers could be skewed towards the small and medium enterprises as the definition used is not aligned to that of an MSME in Nigeria. While the number of employees is the same, turnover or asset estimates are significantly higher
Micro – Turnover <= USD 2 million (N 310 million)/ Assets: <= USD 2 million (N 310 million)
Small – Turnover <= USD 10 million (N 1.55 billion)/ Assets: <= USD 10 million (N 1.55 billion)
Medium – Turnover <= USD 50 million (N 7.75 billion)/ Assets: <= USD 43 million (N 6.665 billion)
[61] Federal Republic of Nigeria & CBN, 2011

2. Increase share of microcredit as percentage of total credit to the economy of 0.9% in 2005 to 20% in 2020; and the share of microcredit as a percentage of GDP from 0.2% in 2005 to 5% in 2020.

3. Ensure participation of all States and the Federal Capital Territory (FCT) as well as at least two thirds of Local Government Areas in microfinance activities by 2015.

4. Increase access to finance for women by 15% per year.

MFBs are defined as unit microfinance banks, state microfinance banks and national microfinance banks (see definitions in Section 3). Other participating entities such as DMBs, non-governmental organisations, microfinance institutions and financial cooperatives are also allowed to operate as MFBs provided that they meet the defined criteria (as defined in Section 3). To minimise any technical skill gaps within MFBs the CBN has put in place a Microfinance Certification Programme to ensure that the management of MFBs have acquired the necessary skills. This certification has helped to unify standards across the MFB sub-sector.

A number of challenges have to date been identified in the MFB industry. Firstly, the CBN has identified that instead of entering the market with developmental goals of greater financial inclusion, many of the licensed MFBs were being run as "mini-commercial banks".[62] Indeed, some of these MFBs entered the microfinance arena as an easy route to a 'banking license' after the 2004 banking consolidation that raised the minimum capital requirements for commercial banks to N 25 billion. As such, the CBN has now stipulated that MFBs must allocate at least 80% of their portfolio to MSME lending (if they are to qualify for the capital requirements of an MFB). Strictly enforcing this will be important to ensure that MFBs help drive financial inclusion.

A second issue that has been identified is that the distribution of MFBs is uneven and many are concentrated in the urban areas. Whilst providing access to finance for all (independent of location) is important, the long term goal of an MFB is to be profitable and sustainable. Forcing an institution to operate in an environment that is not profitable is not sustainable, and as such any interventions to encourage geographical spread should focus on incentivising rather than penalising.

A third issue is that the MFB sub-sector was put under significant pressure during the financial crisis, with MFB clients withdrawing their deposits (during the flight to quality) in response to publicised instances of fraud and high credit losses at certain MFBs which led to their closure. Given the recent difficulties in the sub-sector, it remains important for the regulator to monitor the sub-sector closely and build capacity to ensure that MFBs are sufficiently capitalized and well managed, and when necessary provide liquidity support.

6.1.3. SMEEIS

The Small and Medium Enterprise Equity Investment Scheme (SMEEIS) became operational in 2001 but was terminated approximately 7 years later. SMEEIS mandated that all banks in Nigeria set aside 10% of their annual after tax profits for investing in SMEs (where SMEs were defined as enterprises with a maximum asset base of N 1.5 billion with no upper limit on

[62] Microfinance Africa, 2011.

number of staff).[63] The funding to be provided under the scheme was to take the form of equity investment in eligible enterprises and/or loans at single digit interest rate in order to reduce the burden of interest and other financial charges under normal bank lending; as well as provide financial, advisory, technical and managerial support from the banks.[64] Every legal SME was covered by the scheme except for those in trading/merchandising or financial services.

SMEEIS was suspended in 2008 as it failed to make "any significant impact towards SME growth in Nigeria"[65] for a number of reasons. Firstly, investing and holding equity in SMEs is difficult for banks for a number of reasons - SMEs often do not have formal board procedures or appropriate corporate governance to manage external shareholders; and representatives from banks tend to lack the required skills of an equity investor.[66] The employment of private equity specialists (with market knowledge) by banks or the creation of specialist private equity funds often proved too costly for the expected return given the size of the underlying companies.[67]

Another major issue was that deciding which SME to invest in was costly, confusing and time consuming. As such, although it is difficult to prove, it appears that many banks did not undertake comprehensive due diligence.[68] Instead some was alleged to have provided equity to firms whose loans had gone bad to enable them to pay these off or used the investment as political leverage with SMEs.[69] As such, although valuable returns could have been made on the equity, SMEs with the greatest potential were not always chosen.

Thus because banks saw SMEEIS as a burden rather than an opportunity to generate return, they tried to minimize the costs rather than maximize the returns. SMEEIS is a clear example of the way in which profit seeking institutions like banks may seek to manipulate regulations to minimize any negative impact on their own profits. In the case of SMEEIS, it appears that government recognized the weaknesses of the scheme and there is currently no indication that SMEEIS will be reinstated in the near future.[70]

6.1.4. OTHER REGULATORY ISSUES

6.1.4.1. TAXATION

Another area of legislation that requires attention is the taxation laws for MSMEs. A global survey conducted by the World Bank identified that the second most cited growth constraint for MSMEs is taxation rates.[71] In Nigeria, this problem is heightened by the fact that Federal and State level taxation laws have given rise to multiple taxation policies. As such, "businesses may be subject to as many as 100 different taxes, charges, fees and levies".[72] The time and money spent by MSMEs in navigating this complex system are a burden to their profitability and growth potential. It is important that the current taxation system be simplified and consolidated, to ensure that firms are not being over-taxed and that time wastage is minimized.

---

[63] Central Bank of Nigeria, undated (a)
[64] Central Bank of Nigeria, undated (a)
[65] Terungwa, 2011
[66] Abereijo, 2005
[67] Interviews with Nigerian commercial banks conducted by Genesis Analytics and EFInA, January 2012
[68] Abereijo, 2005
[69] Interviews with Nigerian commercial banks conducted by Genesis Analytics and EFInA, January 2012
[70] Interviews with the CBN conducted by Genesis Analytics and EFInA, 1 Feb 2012
[71] World Bank 2011b.
[72] Pitigala et al., *2011*

Most countries now try to actively lessen the tax burden and simplify its application to MSMEs.[73] This reiterates the importance of getting the fundamental infrastructure right.

6.2. ENABLING ENVIRONMENT

6.2.1. IDENTIFICATION DOCUMENTS

The lack of a unique national identification (ID) card remains a major problem for the country. In 2007, the Federal government charged the NIMC to develop the nation's identity system. In March 2012, NIMC launched the National Identity Database (NIB) which is expected to incorporate all citizens' data into a single database. . Establishing a unique national identifier is both logistically challenging and costly (elements that are exacerbated by the scale of the Nigerian population and the informal nature of living in many urban hubs). Enrolment centres are being prepared nationwide for commissioning in the second quarter of 2012, and once commissioned, enrolment of citizens is expected to commence. Until all Nigerians have been enrolled, assigned unique numbers and provided ID cards, DMBs will continue to cite the lack of unique identification as a source of frustration.[74]

The inability of financial institutions to identify their customers using a unique identifier means that borrowers can show a range of ID options when asked to identify themselves (sometimes causing issues of multiple identities).

Although promoting public support initiatives directed specifically at MSMEs will be important, it is equally (if not more) important that sufficient attention and funding be directed at getting the fundamentals such as an ID system right.

6.2.2. CREDIT BUREAUS, REGISTRIES AND RATINGS AGENCIES

The introduction of 3 credit bureaus in Nigeria has helped to make data more freely available on the credit status of borrowers. The current regulatory requirement is that institutions register with at least 2 of the credit bureaus.[75] To ensure that the system is optimized it will be important for the CBN and government to support and incentivize both DMBs and MFBs to register and report information to the credit bureaus.

Interviews with banks suggested major problems and concerns with processes of securing and registering collateral. Modernisation of collateral registry is therefore an important area for reform.

Finally, in addition to providing readily available information on borrowers it is also important to develop a system to disseminate information on the borrowing institutions themselves. To this end, a ratings agency for MFBs would be very helpful for both the MSME borrowers and for the regulators. Whilst a number of stakeholders are currently discussing the idea (as discussed later in this report) presently there is no such rating agency in the market and this represents a potential area for development.

---

[73] Gordhan, 2012
[74] Genesis interviews with DMBs in Nigeria in Jan 2012
[75] CBN requirements

6.3. PARTIAL CREDIT GUARANTEE SCHEMES

6.3.1. SMECGS

Launched in April 2010, the Small and Medium Enterprise Credit Guarantee Scheme (SMECGS) is a guarantee scheme available to participating banks (DMBs and MFBs) in Nigeria for guaranteeing lending to SMEs. The fund is N 200 billion (USD 1.29 billion) in size. For the scheme, SMEs are defined as having assets (excluding land) not exceeding N 300 million (USD 1.9 million) and between 11-300 employees (the national definitions). Notably, micro enterprises are not included. It is the responsibility of the SME to notify the participating bank that they wish to utilize SMECGS to cover their loan (after which the participating bank makes the application to the CBN on their behalf). It is up to the participating bank to advertise the scheme to borrowers.

The CBN wholly funds the scheme and is the managing agent and responsible for the day to day administration of SMECGS. The CBN has the authority to monitor the projects. The modalities for participating banks are that the maximum loan size distributed will be N 100 million (USD 645 000) and maximum loan tenure will be 7 years and/or a working capital facility of 1 year with provision for rollover. The turnaround time is stipulated to be no more than 60 days. The participating banks' lending rate is the prime lending rate. Every loan must be collateralized with "adequate collateral" that is both realizable and acceptable to the participating banks, as stated in the guidelines.[76] The CBN has committed that the guarantee will cover 80% of the principal and interest. The guarantee will be executed at the point of loan disbursement and can be redeemed once the loan has been declared as a non-performing loan (NPL).

As yet, it is unclear how effective SMECGS has been given that it was only launched in 2010 and loans can be as long as 7 years in tenure. Genesis interviews with DMBs found that knowledge of the scheme is limited[77] suggesting that its impact is yet to be fully realized. SMECGS does have the potential to be highly effective in the market, but its effectiveness depends on a variety of factors which are discussed below.

Firstly, it is important to get the modalities and eligibility criteria right to ensure the scheme is relevant to both SMEs and banks and is sustainable in the long run. The CBN has some concerns that the interest rates charged by the participating banks will be too high (no limit has been set on interest rates) which may lead to little demand from SMEs.[78] There is however currently some discussion at the CBN about introducing an interest drawback program, where SMEs would pay one level of interest up front, but upon successful repayment of the loan would receive some of the interest as a rebate (no definite plans have yet been announced).[79]

Secondly, it is also possible that SMEs may struggle to meet the collateral requirements given that many SMEs lack the necessary collateral to apply for standard loans from commercial

[76] Central Bank of Nigeria, undated (b)
[77] Genesis Analytics and EFInA interviews that were conducted with a few commercial Nigerian banks and organisations like SMEDAN, RUFIN and GIZ-SEDIN revealed little market knowledge of the scheme
[78] Interview at CBN offices, Abuja, with a number of CBN employees on 1 Feb 2012. Interview conducted by Genesis Analytic and EFInA representatives
[79] Interview at CBN offices, Abuja, with a number of CBN employees on 1 Feb 2012. Interview conducted by Genesis Analytic and EFInA representatives

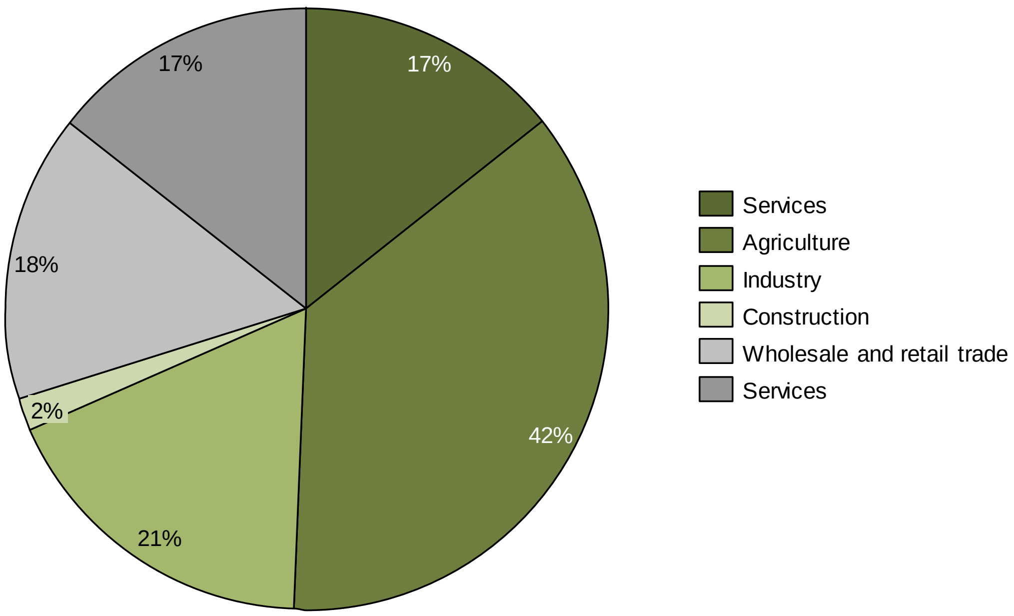
banks. Stipulating that loans are "adequately collateralised", suggests that no unsecured lending may occur and this may be too restrictive and exclude a large proportion of SMEs.

Finally, if financial institutions believe that the CBN evaluation process will be time consuming, the uptake of the SMECGS may be limited.

6.3.2. ACGSF

The Agricultural Credit Guarantee Scheme Fund (ACGSF) was launched in 1977 with a view to supporting growth in the agricultural sector (given its importance in the economy as indicated in Figure 7 below.[80] The government deemed it necessary to implement (and sustain) the ACGSF because many financial institutions view the agricultural sector as highly risky due to unpredictable weather conditions and fluctuating global commodity prices. The provision of loan guarantees was therefore implemented to support access to credit for the agricultural sector.

Figure 7: Sectoral Contribution to GDP, 2009



Source: Agricultural Credit Guarantee Scheme Fund, 2009

The ACGSF is managed by the Development Finance Department of the CBN and jointly funded by the Federal Government and the CBN. The ACGSF guarantees bank loans to the agricultural sector of up to 75% of the amount in default net of any security realized. Feasibility reports are needed for loans over N 20 000 (USD 129). The credit disbursal limits are N5 million (USD 32 000) for cooperatives and N 10 million (USD 64 000) for corporates.

It is required that all loans above N 20 000 (USD 129) be collateralized with a variety of collateral options available ranging from land, crops, livestock, movable property, life assurance policies, stocks and share, personal guarantees or any other security acceptable to

[80] Central Bank of Nigeria, undated (c)

the bank. By allowing banks to stipulate the collateral required (and allowing unsecured lending for loans less than N 20 000) the scheme has given banks sufficient flexibility to make the scheme viable.

The procedure for claiming the guarantee from the CBN is set up such that banks must apply for a claim on default. The CBN ascertains that due diligence has been completed by the bank and assesses the claim. The average time to claim from the guarantee is estimated by the CBN to be 3 months.

Since inception, there have been a number of adjustments and additions made to the ACGSF to enhance its effectiveness. A notable introduction in 2004 was the interest drawback programme (IDP)[81], which has allowed borrowers to enjoy a rebate on the interest paid if they repay their loans on time. The IDP has an authorized capital fund of N 2 billion (USD 12.9 million) which is independent of the capital set aside for the ACGSF. The IDP is jointly funded by the Federal Government of Nigeria (60%) and the CBN (40%). The IDP rate is specified by the CBN at the beginning of each financial year. The CBN state that the introduction of the IDP has lowered the claims on the ACGSF by incentivizing borrowers to repay timeously (although no figures were provided to certify this).[82]

Examining the ACGSF's 2009 Annual Report revealed that for the year ending December 2009, a total of 53 639 loans valued at N 8.35 billion (USD 53.8 million) were guaranteed (average loan sizes therefore being N 155 670 or USD 1 000). This relatively small loan size suggests that the scheme has been successful in supporting access to credit for small enterprises. 90% of loans distributed went to individual borrowers.

From inception in 1977 until 2009, the total loans guaranteed were N 34.4 billion (USD 221.9 million). In 2009, 79 banks (9 DMBs and 70 MFBs) participated, with Union Bank of Nigeria, First Bank of Nigeria and Bank PHB registering 56%, 31% and 9% respectively of the total value of loans guaranteed. That three banks have accessed 96% of the scheme, suggests that while the ACGSF may have been fairly successful in developing agricultural lending at these three banks it has failed to have a major impact on the other DMBs or MFBs. To have a greater impact on other banks the modalities of the ACGSF may need to be adjusted.

Of the loans guaranteed in 2009, 34 300 valued at N 3.81 billion (USD 24.5 million) were recovered which was 41% of the loan repayment target for that year. In 2011, 50 366 loans valued at N 7.2 billion (USD 46.4 million) were recovered, representing 70% of the loans guaranteed in that year.[83] This suggests that for the scheme to be profitable and sustainable banks may need to work harder on their due diligence to ensure that NPLs are lowered. It is nonetheless one of the most long standing public initiatives in the Nigerian financial market.

[81] Central Bank of Nigeria, undated (d)
[82] Interview at CBN offices, Abuja, with a number of CBN employees on 1 Feb 2012. Interview conducted by Genesis Analytic and EFInA representatives
[83] Central Bank of Nigeria, 2012d

6.4. STATE OWNED ORGANISATIONS

6.4.1. BANK OF INDUSTRY

The Bank of Industry (BOI) was established in 2001 following the reconstruction of the Nigerian Industrial Development Bank. As with many development banks their mandate has mutated from a focus on supporting the industrial sector to supporting SME lending, as Government policy priorities have shifted. Their current mandate is to provide financial assistance for the establishment of large, medium and small projects; as well as expansion, diversification and modernization of existing enterprises; and rehabilitation of ailing industries. The BOI is involved in a wide range of activities which include medium and long term finance to industry, equity financing, management of dedicated funds on behalf of public and private sector agencies and donors, lease financing, international trade services, and has subsidiaries in leasing, insurance brokerage, microfinance, a Bureau de Change and registrar/trust service. The BOI's equity is owned by the Federal Government (58.86%), the CBN (41.12%), and by private investors (0.02%). The BOI receives funding in the form of lines of credit from official entities.

As indicated in the table below, the BOI has made notable progress over the last 5 years in consolidating their position and expanding the value of loans disbursed.

Table 14: BOI Progress from 2005-2010

	2005	2010	% Increase/ Reduction
Cumulative value of loans and investments	N 9.8 billion (USD 63.2 million)	N 114.3 billion (USD 737.4 million)	1 066 ↑
Cumulative job creation	150 000	1 000 000 +	566.7 ↑
Portfolio at risk	65%	<22%	43 ↓
Group profit before tax	N 105 million (USD 677k)	N 2.578 billion (USD 16.6 million)	2 355 ↑

Source: Bank of Industry, 2010

However, of a total balance sheet of N 191 billion (USD 1.2 billion) in 2010, only N 38 billion (USD 237 million or 0.4% of the credit provided by the banking sector) was loaned out to retail borrowers.[84] The BOI balance sheet is approximately a tenth of the size of the assets of the largest bank, First Bank Nigeria.[85] With 50% of its balance sheet (N 98 billion or USD 612 million) currently on deposit with deposit money banks in Nigeria, the BOI is an important source of liquidity for the banking sector.

The complexity of executing on a mandate that includes supporting MSMEs is highlighted by BOI distribution network. With only 5 branches compared to the 315 or more branches that is the average for deposit money banks,[86] and a staff of 145 people in 2010, BOI can only effectively operate as a wholesale institution supporting large corporates and/or acting as a financial intermediary with regard to the banking sector. Despite this, the BOI has over time reported an increasing share of its lending being directed at SME's as indicated in Table 15

[84] Bank of Industry, 2010
[85] First Bank of Nigeria, 2010
[86] Central Bank of Nigeria, 2012a – 6605 branches for 21 DMB (after mergers)

below. Recognizing this constraint, BOI states in its 2010 annual report that it will also focus on lending to large corporations that have strong MSME linkages.

Table 15: BOI Retail Portfolio Proportional Values Disbursed (2001-2010)

	2001	2006	2010
Large corporates	65%	15%	4%
SMEs	35%	85%	96%

Source: Interview with Bank of Industry conducted by Genesis Analytics and EFInA on 1 Feb 2012, Abuja.

As an intermediary, BOI is increasingly playing a re-financing role with respect to the banking sector in which it is a provider of longer term and cheaper financing to DMBs to enable them to refinance troubled exposures in priority sectors, thus reducing the likelihood of default. Although undoubtedly beneficial to the companies concerned, such a strategy plays a role in concealing the true quality of the participating banks' loan portfolio, and may result in a concentration of risk in the BOI which will ultimately be borne by its shareholders. The 2010 annual report unfortunately does not disclose the extent of such re-financing, but it is clear that such lending is non-additive with respect to SME lending.

The BOI is increasingly playing a role as a development fund administrator and has been appointed as the administrator of the Dangote Foundation's N 5 billion Small Business Development Fund and the UNDP's USD 4 million access to renewable energy project in Nigeria. It also has responsibility for a number of domestic development funds including Micro Enterprise Development Fund (N 3 billion or USD 19.4 million) in 9 states, the CBN's Intervention Fund (N 500 billion or USD 3.2 billion), the Cotton Textile and Garment Industries Revival Scheme (N 100 billion or USD 645 million) and the Rice Processing Fund (N 10 billion or USD 64.5 million).

6.4.2. NERFUND

The National Economic Reconstruction Fund (NERFUND) was set up in 1989 with a view to catalysing the growth of the SME sector through medium and long term funding. The fund was initiated with a capital fund of N 300 million (USD 1.9 million) jointly subscribed by the Ministry of Finance and the CBN. The Fund received further funding from the African Development Bank in 1992. In 2010, the Federal Government provided a further N 200 billion (USD 1.29 million) stimulation package. The fund is managed by a NERFUND Committee and the loans are disbursed both directly to SMEs as well as on-lent to financial institutions.

The aims and objectives of the Fund are to:[87]

1. Correct any observed inadequacies in the provision of medium to long term financing to small and medium scale industrial enterprises, especially for manufacturing and agro-allied enterprises and ancillary services.
2. Provide medium to long term loans to participating commercial and merchant banks for on-lending to SMEs for the promotion and acceleration of productive activities in such

[87] Economic Confidential, 2011.

enterprises (these are to be available in Naira or foreign currency depending on the SME needs).

Eligible SME enterprises must be involved in any of the following activities: manufacturing, mining, quarrying, agro-allied, industrial support services, equipment leasing and other ancillary services. Furthermore, the enterprise must be wholly Nigerian-owned and certain inputs need to be locally sourced.[88]

Micro loans must be less than N 5 million (USD 32 200) whilst small loans can exceed N 5 million.[89] It is not clear what definition NERFUND use to assess whether an enterprise qualifies for a micro or small loan. The interest rate chargeable is 2% above the Monetary Policy Rate (MPR), inclusive of administrative expenses.

NERFUND has partnered with a number of agencies including SMEDAN, National Directorate of Employment, National Centre for Women Development, Enterprise Development and National Board for Technology Incubation. It appears that the public can apply for loans either directly by writing to NERFUND with their business proposal or through one of the agencies listed above.[90]

Of the 266 projects that were approved between 1990 and 1998, 210 had fully repaid their loans by 2011.[91] In 2010 and 2011, the Fund approved 721 new projects – most of which were micro credit loans. Given that NERFUND is disbursing significant amounts of money a greater amount of information regarding their operations would be valuable. While a NERFUND website exists, no financial reports are published online. As such, a full evaluation of the scheme has been difficult. Greater transparency on the impact of NERFUND is vital.

6.4.3. BANK OF AGRICULTURE

The Bank of Agriculture (BOA) is a government owned institution (CBN 40% and Federal Ministry of Finance 60%) which is supervised by the Federal Ministry of Agriculture. The Bank of Agriculture was incorporated as the Nigerian Agricultural Bank in 1973 and was renamed the Nigerian Agricultural and Cooperative Bank in 1978. In 2000 it merged with the People's Bank of Nigeria and absorbed the risk assets of Family Economic Advancement Programme (FEAP) to be renamed as the Nigerian Agricultural Cooperative and Rural Development Bank Ltd (NACRDB). In 2010 it was renamed the Bank of Agriculture.

Presently, the BOA is undergoing a process of rebranding and the repositioning agenda is based on the following three principles: modernization, institutional capacity enhancement and a refocusing of the Bank's key mandates. Their mandate is to provide low cost credit to small holder and commercial farmers and SMEs operating in rural areas. They also aim to provide some micro funding to SMEs involved in some nonagricultural activities. The BOA offers the following products: range of savings accounts, a micro loan scheme, a collaboration scheme (collaborating with development agencies, governments and NGOs) and an on-lending scheme (making funding available through government agencies and cooperative groups).

---

[88] The input specifications vary across enterprises
[89] Economic Confidential, 2011
[90] Economic Confidential, 2011
[91] Economic Confidential, 2011

Due to the current restructuring that the bank is undergoing, a full analysis of the institution has not been included in this report due to the lack of up to date information such as Annual reports, but given its potential impact on MSMEs, progress should be monitored in the future.

6.5. APEXES AND WHOLESALE FUNDING

6.5.1. N 200 BILLION FUND FOR REFINANCING AND RESTRUCTURING FOR THE MANUFACTURING SECTOR

Approved by the CBN in 2010, to be issued and administered by the BOI, the fund's objectives are to fast-track the development of the manufacturing sector, improve the DMB's financial position (by helping to refinance and restructure badly performing manufacturing loans) and more generally increase output and employment. A manufacturing company is defined as: being involved in the production and processing of tangible goods or the fabrication/deployment of plants/machinery/equipment; delivery of goods or provision of infrastructure to facilitate economic activity in the real sector. Such an entity must not be involved in the financial services industry. For this Fund, SMEs are defined as entities with an asset base (excluding land) of between N 5 million and N 500 million (USD 32 200 – USD 3.2 million) with between 11 to 300 employees.

Participating banks are DMBs and DFIs (excluding the BOI). The maximum loan amount is N 1 billion for a single obligor in respect of refinancing/restructuring. The Fund is administered at an all-in interest rate/charge of 7% per annum payable on quarterly basis. Specifically, the Managing Agent (BOI) shall be entitled to a 1% management fee and the commercial banks, a 6% spread. Loans shall have a maximum tenure of 15 years and/or working capital facility of one year with provision for rollover and the Fund also allows moratorium in the loan repayment schedule. Projects under the Fund are subject to verification by the BOI. The Fund has been over-subscribed and banks have used it to refinance bad loans and improve the quality of their loan books.[92] At the end of December 2010, N 199.6 billion had been disbursed to 539 beneficiaries across twelve different sectors of the economy.[93] The CBN recognises that the scheme predominantly targets the SME sector rather than the micro segment.

6.5.2. ACSS

The Agricultural Credit Support Scheme (ACSS) is a joint initiative of the Federal Government of Nigeria and the CBN. It is a prescribed Fund of N 50 billion (USD 322 000) from various public and private entities. N 35 billion (USD 220 million) of the funding was provided by various deposit money banks, N 6 billion (USD 39 million) was from SMEEIS, N 5 billion (USD 32 million) from the Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB now Bank of Agriculture (BOA)), N 2 billion (USD 13 million) from ACGSF and the remainder from state governments and debt relief[94]. The objectives of the Fund include developing "the agricultural sector of the Nigerian economy by providing credit facilities to farmers at single digit interest rates". It is specified that loans are to be disbursed to farmers and agro-allied

[92] Interviews with DMBs, conducted by Genesis and EFInA, Jan 2012, Lagos & Interview with the CBN conducted by Genesis and EFInA on 1 Feb 2012, Abuja
[93] Central Bank of Nigeria, 2011
[94] Central Bank of Nigeria, 2006

entrepreneurs at 14% per annum, but that upon timely repayment, applicants are entitled to a 6% rebate making the effective rate 8% per annum.

Agricultural purposes covered under the Fund are listed below:

1. Establishment or management of plantations
2. Cultivation or production of crops
3. Livestock (animal husbandry, poultry, fishery etc.)
4. Farm machinery and hire services

6.5.3. CACS

The Commercial Agricultural Credit Scheme (CACS) was established in 2009 as a collaboration between the CBN and the Federal Ministry of Agriculture and Water Resources.[95] The aim of the scheme is to support finance for the agricultural value chain (production, processing, storage and marketing). The scheme is financed through a N 200 billion (USD 1.29 million) 7 year bond raised by the Debt Management Office.

The Fund is available to participating banks and state governments to finance agricultural enterprises. All DMBs in Nigeria are eligible to participate and are required to bear all credit risk for loans granted. Maximum loan size is stipulated to be N 2 billion. In addition, each State Government is eligible to borrow up to N 1 billion for on-lending to farmers' cooperatives societies. Eligible borrowers are corporate and large scale commercial farms and agro enterprises, medium scale commercial farms and agro-enterprises and also State Governments.

Loans to eligible entities are disbursed at a rate of 9% per annum. The CBN is responsible for subsidizing this rate and also for the administrative expenses of the Scheme. The Scheme has been operated in two tranches with the first N 100 billion (USD 645 million) disbursed from May to December 2009 and the second tranche of N 100 billion (USD 645 million) disbursed from February 2010. As at March 2012, the CBN had released a total sum of N 175.5 billion (USD 1.1 billion) for disbursement to 222 beneficiaries (made up of 193 private promoters and 29 State Governments).[96]

Because the Scheme is largely aimed at large and corporate enterprises, CACS is not the focus of this report.

---

[95] Central Bank of Nigeria et al, undated (e)
[96] Central Bank of Nigeria, 2012c

6.6. SUPPLY SIDE CAPACITY BUILDING

6.6.1. SMEDAN

The Small and Medium Enterprises Development Agency (SMEDAN) was established in 2003 to coordinate, promote and facilitate the growth and development of MSMEs.[97] The institution became operational in 2005 and reports to the Federal Ministry of Trade and Investment. SMEDAN receives funding from the Federal Ministry of Trade and Investment, BOI and NERFUND. SMEDAN has over 300 employees nationally.

SMEDAN is not financially or legally empowered to create interventions, but instead plays an advisory and facilitating role. SMEDAN is involved in a large number of activities such as:

- Delivering demand side capacity building for MSMEs
- Assisting in drafting MSME laws
- Promoting MSME cooperatives
- Collecting information for a national survey of MSMEs
- Developing a ratings agency for MFBs
- Reworking and managing 23 of the Industrial Development Centres (IDCs)

SMEDAN's primary focus is on demand side capacity building of entrepreneurs, through 15 Business Support Centres (BSCs) and 37 Business Information Centres (BICs). In addition, there are Zonal Offices in the six geo-political zones to oversee the activities of the BSCs and BICs. Capacity building is conducted by SMEDAN staff and hired consultants.

Its 2011 Annual Report reveals that the SMEDAN team are embarking on substantive in-house training of its employees (including attendance of international workshops). To date, SMEDAN has had limited success in scaling up its capacity building operations, servicing approximately 9,000 MSMEs during 2011 (out of an estimated 10-50million MSMEs). If the primary focus continues to be capacity building, a strategy to achieve scale will be crucial.

Furthermore, SMEDAN's current role in the MSME sector suggests that it should escalate its role as a data disseminator on MSMEs. The lack of accurate MSME data is often cited as a major developmental hindrance.[98] SMEDAN can leverage its connections with MSMEs and government to capture as much relevant information as possible. By creating a data base for MSMEs as a reliable source of data, SMEDAN could play a valuable role in the sector. Greater coordination between the aid organisations and government institutions would be hugely beneficial, as each of the organisations seems to be conducting their own independent data gathering. Consolidating the data could save both time and money and send a clear message to the market as to where to access the most reliable information on MSMEs. This would not only assist financial institutions and MSMEs, but also empower the Government to design policies that address the needs and gaps in the MSME sector, based on evidence.

[97] SMEDAN, 2011
[98] Interview at SMEDAN offices, Abuja, with a number of SMEDAN employees on 30 Jan 2012. Interview conducted by Genesis Analytic and EFInA representatives

6.6.2. RUFIN

The Rural Financial Institution Building Program (RUFIN) was launched in 2009 and became operational in 2010. It is a seven year program with the aim of actualizing food security, employment and wealth creation in rural areas.[99] Whilst RUFIN's aim is not directed solely at MSMEs, the fact that many MSMEs operate in rural areas means that RUFIN's initiatives will reach them. RUFIN is partly funded by the International Fund for Agriculture Development (IFAD) and the Federal Government of Nigeria. RUFIN has between 300-400 employees.

RUFIN is involved in a range of activities, which include:

1. Demand side capacity building and information facilitation for MSMEs
2. Supply side capacity building and information facilitation for MFBs and other financial institutions[100]
3. Creation of development fund aimed at MFIs

As regards capacity building and information facilitation, on the demand side RUFIN has helped to facilitate the creation of 4,000 MSME cooperatives (15 people per group) which focus on the very poor. These groups have received some elementary financial training and have been linked up with MFBs to help promote access to financial services.

On the supply side, RUFIN has set up a MFB training program which initially entailed a competitive process where 154 MFBs applied for training. Out of the 154 applicants, 33 MFBs were chosen and have received mentoring from RUFIN. These 33 MFBs have been connected with the 4,000 MSME cooperatives described above. RUFIN state that the impact of their mentoring has been to increase deposits of these MFBs by 150% and helped to extend credit in the rural areas. Whilst it remains hard to measure, RUFIN estimates that this mentoring has increased credit to the rural areas to N 175 million (USD 1.1 million) in 2011 – which is far short of the demand which they estimate is closer to N 1 billion (USD 6.4 million).[101] No information was available regarding any future training.

As regards information facilitation, RUFIN has been involved in a number of different initiatives. The first is the promotion of awareness amongst MFBs about the benefits of MixMarket (a financial data and performance indicator website for microfinance which lists information on MFBs in an easily comparable manner). Thus far, 41 Nigerian MFBs have been listed on MixMarket. Incentivising all MFBs to list on MixMarket would help to create a more transparent microfinance sub-sector in Nigeria.

The second is that RUFIN has been researching the benefits of institutionalising a ratings agency for MFBs in Nigeria (following a model already implemented in Bangladesh). To cover the costs of this process, RUFIN propose that MFBs fund 50% of the ratings fee, which will be matched by funding from RUFIN. Because many MFBs may not currently see the benefit of the ratings agency it will be important to educate them as to why investing is worthwhile. As

---

[99] RUFIN, undated

[100] RUFIN does conduct some training for Financial cooperatives and informal financial institutes but intelligence gained through interviews with RUFIN staff suggested that RUFIN's main impact has been through (complete sentence)

[101] Interview at RUFIN offices, Abuja, with a number of RUFIN employees on 31 Jan 2012. Interview conducted by Genesis Analytic and EFInA representatives

discussed earlier in this report, both the CBN and SMEDAN are researching the benefits of an MFB ratings agency, therefore coordination between the two agencies would be beneficial.

The final initiative that RUFIN is involved in is the MFI development fund (in collaboration with the CBN) with an expected size of N 200 billion or USD 1.29 billion.[102] Whilst no concrete plans have been signed, it is expected that 60% of the fund will be set aside as a credit line and guarantee fund to help MFBs refinance debts and extend new credit lines. It is anticipated that the remaining 40% will be in the form of grants to MFBs to be utilised for capacity building and other developments. Given the risks associated with lending to MSMEs, setting up a development fund to help promote innovation in MSME lending could be important in driving progress in this sector.

6.7. OTHER

6.7.1. THE NATIONAL POVERTY ERADICATION PROGRAM

The National Poverty Eradication Program (NAPEP) was introduced in 2001 to focus on eradicating absolute poverty in Nigeria.[103] NAPEP complemented the National Poverty Eradication Council (NAPEC) and focused on a variety of targets. Whilst the NAPEP website is no longer functional,[104] recent announcements suggest that NAPEP continues to disburse funding.[105].

6.7.2. THE AGRICULTURAL TRANSFORMATION ACTION PLAN

Whilst presently there is limited information available on ATAP, (the Agricultural Transformation Action Plan) it has been announced by the Minister of Agriculture, Dr. Akinwunmi Adesina, that the initiative will focus on five crops – rice, cassava, sorghum, cocoa and cotton.[106] Given that many MSMEs operate in the rural agricultural sector it is likely that ATAP will have an impact on the MSME sector. It is projected that the programme will inject N 300 billion (USD 2 billion) additional income into the hands of Nigerian farmers, and N 350 billion (USD 2.2 billion) into the economy by ensuring sufficiency in rice production. The exact modalities of how this funding (and the exact funding amount) have not yet been published, but progress should be monitored.

6.7.3. NIRSAL

The Nigerian Incentive Based Risk Sharing System for Agricultural Lending (NIRSAL) was launched in 2011 with a view to creating a “singular transformation, one bullet solution”[107] to promote the agricultural sector. The scheme is still in early stages of development and is not yet active. NIRSAL is designed to take a dynamic and holistic approach that tackles both the agricultural value chain and the financing of the value chain. As is the case with the ACGSF, MSMEs’ work in agriculture, which means that NIRSAL will impact the sector.

---

[102] Interview at CBN offices, Abuja, with a number of CBN employees on 1 Feb 2012. Interview conducted by Genesis Analytic and EFInA representatives
[103] Obadan, undated
[104] See website at http://www.napep.gov.ng/
[105] Isaac, 2012
[106] Logbaby, 2012
[107] Central Bank of Nigeria, undated (f)

NIRSAL's broad objectives are to[108]

1. Increase banks' lending to the agricultural sector from 1.4% (current lending levels) to 7% of banks' total lending within 10 years.

2. Increase lending to small farmers by 50% of the current total.

3. Increase lending to agricultural producers by N 3.8 million in 2020 (by using pooling mechanisms, value chains, MFIs and cooperatives).

4. Reduce banks' break even interest rate to borrowers from 14.0% per annum to 7.5 - 10.5% per annum.

The CBN is the main funder of NIRSAL. The CBN has set aside N 75 billion (USD 500 million) for NIRSAL. The design team of NIRSAL engaged with over 400 stakeholders including DMBs, MFBs, borrowers and government departments and utilized data collected to design 10 year cash flow models for the NIRSAL Fund. The Fund is based on five pillars which are described below in Table 16.

Table 16: Five Pillars of NIRSAL

	Five Pillars of NIRSAL				
Name	Risk sharing facility	Insurance facility	Technical assistance facility	Holistic bank rating mechanism	Bank incentive mechanism
Description	N 45 billion (USD 300 million) Share risks with banks ranging from 30-80% of first loss depending on the segment.	N 4.5 billion (USD 30 million) Expand current insurance products and pilot new ones for products such as weather index, pest and disease insurance.	N 9 billion (USD 60 million) Assist banks to develop agricultural lending capabilities.	N 1.5 billion (USD 1 million) Rate banks according to how effective they are in lending to the agriculture sector.	N 15 billion (USD 100 million) Offer banks incentives to build long term capabilities by awarding cash rewards to winners in Pillar 4.
Goals109	Generate USD 3 billion of additional overall bank lending from the USD 300 million fund.	Expand insurance products from current coverage of N 0.5 million to N 3.8 million.	Equip banks to lend sustainably to agriculture. No other definitive goal specified.	Provide transparency in NIRSAL's outcomes and a basis for awarding incentives and public debate on program efficacy	Incentivize long term capability development.

Source: Central Bank of Nigeria, undated (f)

Whilst the five pillar initiatives of NIRSAL have not yet been officially implemented (and as such full evaluation is impossible), it is possible to make a few preliminary comments. Firstly, as previously mentioned, the current public policy landscape in Nigeria is fairly complicated

[108] Central Bank of Nigeria, undated (f)
[109] Notably, no time frame was given for the completion of these goals

and fragmented (given the number of public initiatives that continue to be introduced and amended). As such, any attempt by the Nigerian government and CBN to coordinate policies into a framework that provides greater clarity to the public should be applauded. NIRSAL's "one-stop" approach for agriculture has the potential to simplify the public landscape for stakeholders and allow for greater coordination between agricultural policies. It is proposed by the CBN that the ACGSF, ACSS and CACS interventions should be incorporated into the NIRSAL framework (as these also relate to agriculture).[110] Given RUFIN's role in agriculture, incorporating some of RUFIN's initiatives into the NIRSAL framework may also be beneficial.

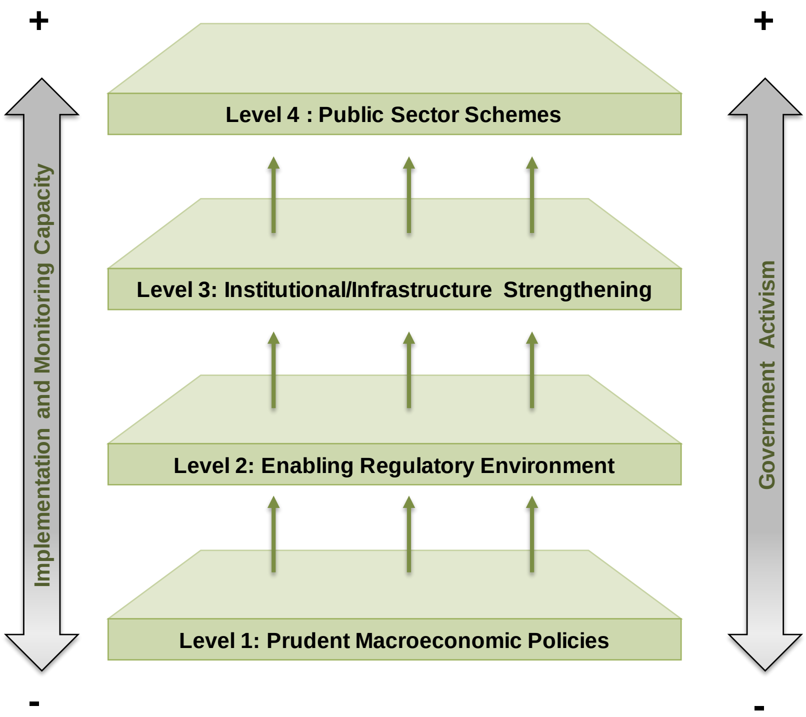
Furthermore, at present although NIRSAL have stated a number of goals, to ensure efficient monitoring and evaluation these goals need greater clarity (with measurable milestones and specified timeframes). Setting up a transparent monitoring process will be fundamental for the program and it is vital that this is done before the program becomes active.

[110] Interview at CBN offices, Abuja, with a number of CBN employees on 1 Feb 2012. Interview conducted by Genesis Analytic and EFInA representatives

7. INTERVENTIONS THAT SUPPORT MSMEs: DESIGN CRITERIA FOR NIGERIA

Effective policy interventions need to be designed to reflect the constraints and opportunities represented by local conditions. As shown in Figure 8, it is widely accepted that a vibrant MSME sector will exist when conditions are appropriate at four different levels. What is important however, is the interaction between these "levels" in any particular context. For instance, MSMEs have been shown to thrive when macro-economic policies produce a predictable demand environment in which MSMEs are able to plan with greater certainty.[111] The Governments of South East Asia are well known for having created environments which provide firms with a stable and competitive exchange rate, low and stable inflation, a steady rate of growth and steady but positive real interest rates on loans. Even with sound macro-economic conditions, MSMEs may still require support from public schemes in some areas.

Figure 8: The Levels that Support Public Policy Initiatives



Source: Genesis Analytics Team Analysis, 2012

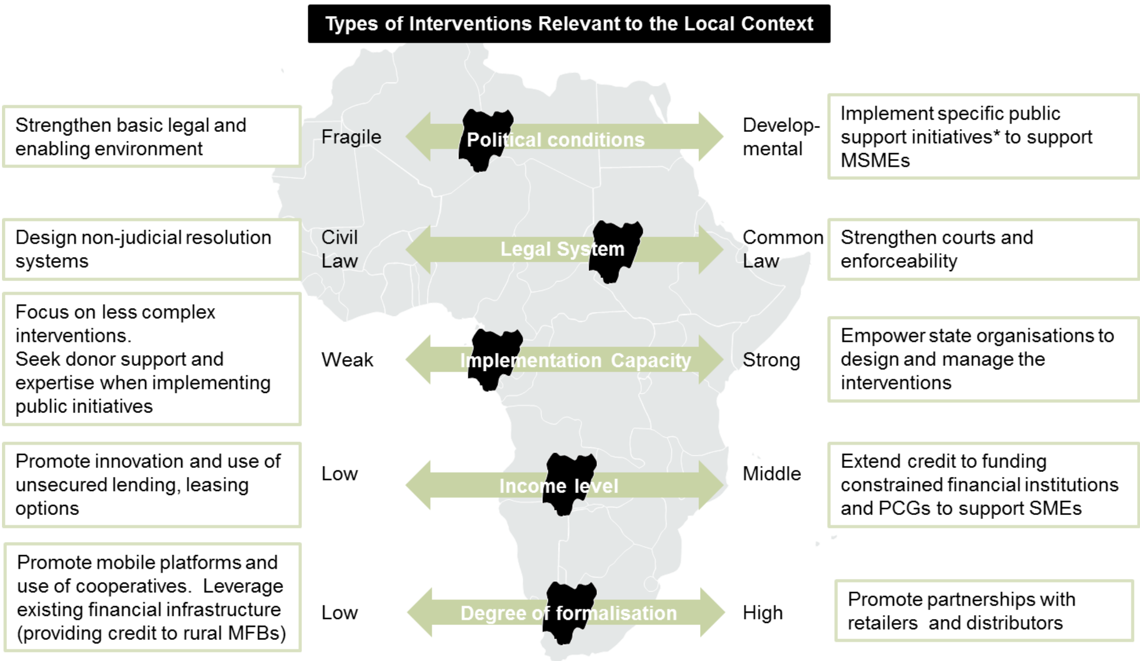
Although macro-economic management in Nigeria has improved dramatically, macro-economic conditions are still quite different from those in South East Asia, and in particular, inflation and thus lending rates remain much higher than in many other countries. With high lending rates, many MSMEs will be unwilling to borrow to grow their businesses, reducing the level of employment created. In such circumstances, governments are often tempted to either cap lending rates or provide funds at subsidized rates. This is indeed the case in Nigeria with

[111] OECD, 2004

numerous schemes including the N 200 billion fund for refinancing and restructuring for the manufacturing sector, requiring that banks on-lend at no more than 7.0% per annum despite inflation running at 12.6%[112]. Clearly such policies will either generate excess demand for loans (on the part of MSMEs, or on the part of institutions bidding for the loans) or insufficient profit margin at the banks resulting in a low take up of the facilities.

Nigeria rates relatively well with respect to some of the more egregious elements of an enabling regulatory environment – the CBN relies on risk and provisions principals with respect to the use of collateral. Credit bureaus have also been established, however perhaps the most important regulatory hurdle for lending to small and medium sized enterprises (if not micro) are processes surrounding the registering and realization of collateral. The World Bank Doing Business report highlights that in Nigeria, registering collateral takes 82 days. The lack of a unique national ID system also makes non-group based lending to micro enterprises extremely difficult (although it is hoped that the work through the NIMC will address this issue in the medium term).

Figure 9: The Nigerian Landscape



Source: Genesis Analytics Team Analysis, 2012

Figure 9 indicates Nigeria's position on the five key socio-political scales (political conditions, legal systems, implementation capacity, income level and demographic density). Although the political situation in Nigeria has stabilised over the past decade, elements of the political sphere are still fairly fragile. As such although Nigeria can implement specific public support initiatives there is still considerable room to strengthen the basic legal and enabling environment. Secondly, although Nigeria benefits from having a common law system given the current state of the legal system in Nigeria, the strengthening of courts and enforceability will help to provide greater accountability in the country.

[112] January 2012 CPI figure, (CBN statistics, 2012)

Thirdly, drawing on the knowledge and experience of donor organisations such as the World Bank and DFID may be beneficial in generating capacity in the design of MSME interventions, to ensure that the Nigerian Government and the CBN's approach to implementing public interventions is robust and effective. Fourthly, Nigeria's current average income levels suggest that initiatives should create a balance between extending credit to funding constrained financial institutions and promoting unsecured lending or collateral options for MSMEs that lack the necessary collateral. Given the very low level of formalisation in many business segments, interventions should focus on the development of microfinance, co-operatives and mobile payment services.

It becomes extremely costly and distortionary if public support systems try at the level of a single institution or facility to overcome problems that are broadly due to macroeconomic conditions. Thus, it is probably an important first principle of intervention design not to try and solve a general problem (such as high interest rates due to high inflation or low levels of deposits to GDP) with a single initiative – such as subsidized loans to a target sector.

A second principle to consider is the role of bank versus non-bank support to the sector. This involves an analysis of the different sources of potentially investable funds in the economy that can be intermediated to meet the needs of the MSME sector and the role of different institutions in the intermediation of such funds to meet the different needs - such as start-up funding, equity, working capital, long term debt, and asset finance. This is very much a function of the structure of the economy and the relative share of financial sector assets held by banks and non-banks. Given the volatility of commodity prices, there is an opportunity for government led funds to be used to capitalise interventions funds during periods of high oil prices and to provide incentives to the banking sector to encourage MSME lending. The important challenge is to ensure that such initiatives are designed to be sustainable over the economic cycle (even if they receive their initial endowment during boom times) and are effectively monitored and evaluated.

The nature and effectiveness of the legal system is a key element of an enabling environment. Although it can take time to reform, it should nevertheless receive considerable attention. In environments in which legal action is lengthy, costly and with uncertain outcomes, interventions such as PCGs, which reduces the losses arising from defaults regardless of the outcome of the legal process, will be particularly effective.

In markets with weak institutional capability, high levels of corruption, or a history of weak corporate governance, interventions should leverage external interventions (for instance becoming co-contributors to schemes that have been designed and will be managed by multilateral agencies such as the IFC), and as far as possible leverage private institutions in the selection of MSMEs.. Thus public support should place considerable focus on interventions that are disbursed via DMBs, and where appropriate allocate public funds through effectively designed auction processes. Auctions have been proven to achieve an efficient and cost effective allocation of public support, that are considerably less costly to manage than creating entire financial institutions either in the form of banks or non-bank financial institutions.

Finally, interventions need to be very clear on the segment of the market to be addressed. Whereas in many markets the MSME credit problem is defined as a "missing middle" i.e. firms that are too small to be treated as corporates but too large to be handled as retail, in Nigeria the problem can be described as a "missing middle and bottom". While there is sufficient competition in the banking sector to drive banks to compete relatively aggressively for the business of medium size firms, they have on the whole, not developed processes required to conduct non-collateralized lending for the many small firms that lack collateral. Moreover, banks have very little understanding of how to serve the millions of micro enterprises in Nigeria. These micro enterprises are more likely to be served by microfinance banks or through partnership strategies (such as co-operatives). The regulatory environment must create room for providing access to financial products through retailers and mobile phones.

8. EVALUATION OF PUBLIC INTERVENTIONS IN NIGERIA

In order to evaluate the effectiveness of the interventions, they must be compared on a variety of dimensions. Table 17 and Table 18 apply the same framework introduced in section 5 that considers how the different interventions affect the DMB's lending decision.

Table 17: Effect of Nigerian Initiatives on the Credit Decision Process

Intervention	Effect on credit decisioning			Comment
Partial Credit Guarantees	Revenue	Costs	Risk	
1. SMECGS	-	✓½	✓	Guarantee schemes reduce banks' risk by guaranteeing a proportion of the loan. They also lower banks' costs by achieving repayment more easily.
2. ACGSF	-	✓½	✓	
3. NIRSAL (pillar 1)	-	✓½	✓	
State banks and donor organisations				
1. BOI	-	✓½	-	The BOI's lending to the public has no effect on revenue or risks of banks' lending. The provision of wholesale funding reduces banks' costs.
2. NERFUND	-	-	-	NERFUND's lending to the public has no effect on revenue or risks of banks' lending.
Apex and wholesale funding				
1. NERFUND	✗	✓	-	Wholesale lending to banks reduces costs by offering funding at subsidised rates. Revenues are also reduced however as the funding conditions tend to place limits on interest rates that banks can charge.
2. N200bn manufacturing refinancing	✗	✓	-	
Supply side capacity building				
1. NIRSAL (pillar 3)	-	✓½	✓	Capacity building initiatives reduce risk by providing training to banks on risk operations. Costs are also reduced as better understanding of risk leads to lower NPLs.
2. SMEDAN	-	✓½	✓	
3. RUFIN	-	✓½	✓	

Scale	Positive effect: ✓	Semi-positive effect: ✓½	No effect: -	Negative effect: ✗

Table 18: Effect of Nigerian Initiatives on the Credit Decision Process

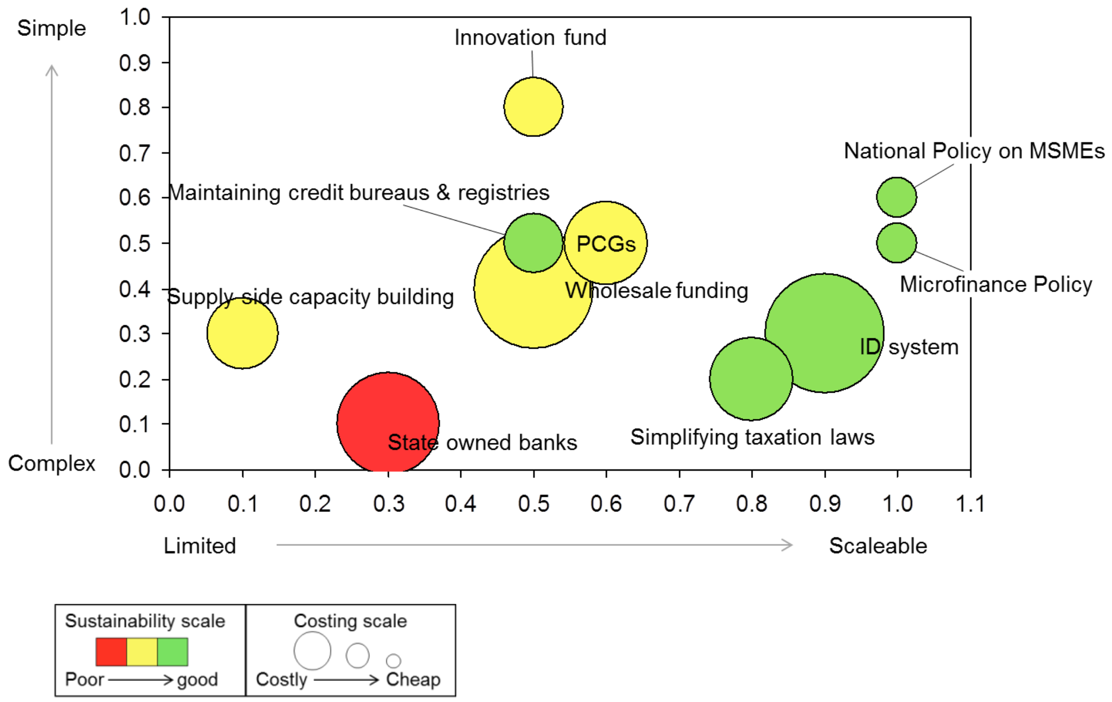
Intervention	Effect on credit decisioning			Comment
Enabling environment	Revenue	Costs	Risk	
1. ID	-	½	✓	Rolling out national ID cards lowers risks by enabling banks to track down all the customers. Costs are also potentially lowered as banks do not need to conduct their own in-house identification scheme which can involve location visits.
2. Credit bureaus & collateral registries	-	✓	✓	Credit bureaus lower risks for banks by making credit information on customers freely available. Collateral registries lower risk by providing a means to certify collateral to back up loans. Costs also fall as banks' in-house collateral certification is no longer needed and borrowers are more likely to repay collateralised loans.
Innovation funds				
1. NIRSAL (pillars 2, 4 & 5)	-	✓	✓	Innovation funds help to drive more efficient ways of lending which help to lower risk as the credit team understand their customers better. They also reduce costs as typically the innovation grant is offered at subsidised interest rates.

Scale	Positive effect: ✓	Semi-positive effect: ½	No effect: -	Negative effect: ✗

Source: Genesis Analytics Team Analysis, 2012

Next, it is important to compare the cost effectiveness of the various schemes in line with the scheme's complexity, cost, sustainability and scalability. This information is depicted below inFigure 10 (see Table 20, Table 21, Table 22 and Table 23 in the Appendix for further details on individual interventions).

Figure 10: Comparison of Complexity, Cost, Sustainability and Scalability of Nigeria's Main Initiatives



Source: Genesis Analytics Team Analysis, 2012

As clearly demonstrated in Figure 10, considerable improvements in the level of credit extension to MSME's would flow from improvements in the general environment, in particular the introduction of a comprehensive national ID system.

With respect to more specific interventions PCG's and innovation funds are probably the most effective direct interventions (from the perspective of scale, sustainability and manageability). Innovation funds could also play a significant role.

A large proportion of the wholesale funding provided at present is related to interventions. as a result of the financial sector crisis. It is not clear whether such funding support is effective in ensuring that DMBs increase access to credit for MSMEs. However, as previously noted, wholesale funding would be much more appropriate for MFB's. The fact that the CBN is considering a scheme to provide apex funding to this sub-sector is to be welcomed.

Shown in red on the charts are state owned banks. This reflects a number of concerns with state owned banks in Nigeria. Firstly given the scale and diversity of DMB's in Nigeria, interventions that leverage their reach and capacity are likely to be much more cost effective and attain greater scale than any single state institution. Secondly the design of wholesale support facilities such as PCG's / wholesale funding / innovation funds is a lot more simple than the creation and management of an entire financial institution. Lastly, it is extremely difficult to establish the appropriate governance framework for state-owned institutions to ensure that they utilise the subsidies they receive (implicit or otherwise) for the intended purpose and do not consume scarce public resources through operating at a lower level of efficiency than DMB's.

The final evaluation looks at which segment (micro, small or medium) public interventions are most likely to have the greatest impact. This information is shown in Table 19 below.

Table 19: Impact of Nigerian Initiatives on the MSME Segments

Intervention	Segment relevance		
	Micro	Small	Medium
General Regulatory Environment			
• National Policy on MSMEs	H	H	H
• Microfinance Policy	H	M	L
• Taxation laws	L	H	H
Enabling environment			
• ID system	H	M	L
• Credit bureaus & registries	L	M	H
Partial Credit Guarantees	M	H	H
State banks	L	M	M
Apex and wholesale funding	H	L	L
Supply side capacity building	M	M	M
Encouraging innovation	M	H	M

Scale	Low impact: L	Medium impact: M	High impact: H

Source: Genesis Analytics Team Analysis, 2012

Table 19 demonstrates a very important principle of intervention design – that a single intervention will not meet the different needs of micro, small and medium businesses, and that the Government needs to maintain a range of interventions to meet the different needs of the entire MSME sector.

DMBs do not have the processes, data or methodologies to engage with micro businesses, so they are unlikely to utilise interventions solely targeted at this segment. Thus improving the level of funding that can be provided on a sustainable basis to MFB's is probably the most important and relevant direct intervention for micro businesses. Also important for the micro segment are innovation funds – grants that support DMB's in developing products and processes to provide non-collateralised loans to micro businesses (on the basis of transactional history, psychographic profiles or any other customer profiling methodology), would be beneficial.

For small businesses a wider range of interventions will be effective including PCG's if these are appropriately designed, i.e. by loosening collateral requirements, developing a portfolio assessment approach, and through favourable payment rules (streamlining the recovery process for banks to encourage uptake). Our interaction with both the regulators and the DMB's indicates that the current process and criteria are overly restrictive to promote effective use of the PCG's or a measurable impact in the market.

The problem for medium businesses in Nigeria is probably less severe than in other segments given the degree of competition in the market. Again definitions are important as the national definition of "medium" would in most markets be considered "small" (using the IFC/World Bank definition).

CONCLUSION

The analysis provided in the body of this document has compared the Nigerian interventions to international best practise and identified the interventions that are most likely to reach scale in a sustainable and cost-effective manner. It is clear that there is no one simple answer as to the best way to promote access to credit for MSMEs, but rather that a multi-faceted approach is necessary. The results suggest firstly that a well-designed and enforced regulatory framework is of fundamental importance and secondly that PCGs and supply side capacity building offer the best potential to increase access to credit for MSMEs in Nigeria.

SMEDAN is in the process of revising its definition of the micro, small and medium segments, and setting out new targets and interventions for the sector. It will be important that the segment band definitions are not inflated to distort incentives. If segments are too broadly defined (i.e. that the upper band of the micro segment is raised to incorporate what were previously defined as small firms), there is a risk that this might adversely impact financial institutions' lending. For instance, MFBs are supposed to predominantly provide services for the micro segment and if the micro segment is too broadly defined then MFBs may end up targeting the upper band of the micro segment thereby excluding the smallest micro firms. Furthermore, given that there appears to be some confusion as to the correct definition of MSMEs. Therefore, once the definition of MSMEs has been revised it is important that the financial industry is unified in utilising the new definition.

In terms of the legislation for microfinance, the CBN stated in meetings[113] that MFBs allocate at least 80% of their lending portfolio to MSMEs. This information is not however included in the revised Microfinance Policy and it would be worthwhile including this in the regulations and monitoring adherence by MFBs. Furthermore, given the recent strain that the MFB sub-sector was under as a result of the financial crisis, the CBN will need to ensure that MFBs are sufficiently capitalized.

On the taxation laws, Nigeria currently has a very complex system that is both difficult and costly for firms to navigate. Simplifying this system would be fairly complex to achieve but the effect on business would be significant. As such, it is an important area for the Government to consider when promoting access to credit for MSMEs.

More generally, with regards to legislation, it is important to understand that banks are profit making institutions, so placing restrictions that may impact their ability to maximise their profits (such as interest rate caps or directed lending to a specific sector) can often have unintended consequences and could be detrimental and undermine the purpose of the intervention. One such example of a rather unsuccessful intervention was SMEEIS.

Of equal importance is the role of the enabling environment in supporting MSMEs. The introduction of credit bureaus must be applauded and although insufficient time has passed to fully assess their impact. Going forward, it will be important for the government and the CBN to ensure their sustainability and to encourage banks to fully utilise them. Secondly, with respect

---

[113] Interview at CBN offices, Abuja, with a number of CBN employees on 1 Feb 2012. Interview conducted by Genesis Analytic and EFInA representatives

to a national ID system in Nigeria, while the work at the NIMC must be commended, presently Nigeria still lacks a nationwide unique identifier. Although the issuance of national IDs has been (and will continue to be) expensive and logistically challenging given the size and complexity of the Nigerian population, a unique national identifier is important to DMB's in the credit decision process. Providing identification for the entire population will lower banks' risk perceptions as tracking down borrowers will be easier. As such, ID cards will indirectly help to promote access to credit for micro and small enterprises. Finally, given the concerns that the DMBs raised over the registration of collateral, collateral registries in Nigeria should be reviewed and the processes modernised where possible to help simplify and validate the process.

Of the direct initiatives, it appears that the PCGs have the greatest ability to impact the credit decision process of banks. Whilst the schemes can be quite expensive, they offer a chance for banks to develop long term, sustainable capabilities in lending to segments that would typically have been deemed too risky to extend credit to. However the success of PCGs lies in their design and it has been shown that overly restrictive modalities and eligibility criteria reduce the attractiveness of the scheme to banks and MSMEs resulting in low take-up. Drawing on international best practice will be highly informative given their widespread use across the globe. Notably, PCGs have typically been most successful in promoting access to credit for SMEs with some formal collateral but those firms with informal types of collateral have struggled to access the PCGs. Amplifying the reach of PCGs may require adjusting the current PCG design by relaxing the current collateral requirements. Finally, it is essential that in the event of default, the payment from the scheme is guaranteed to be quick and efficient.

Supply side capacity building has the potential to cut across all segments of the MSME sector (depending on whether the training is targeted at MFBs or DMBs) and as such may be a viable solution for promoting access to credit for MSMEs.

Regarding the other direct incentive schemes, it is not clear whether the benefits outweigh the sizeable costs. Wholesale funding initiatives will be most effective when targeted at institutions that are funding constrained. Whilst the majority of the schemes currently available (such as the N200billion manufacturing refinancing scheme) are targeted at the DMBs, it is in fact the MFBs that are funding constrained. As such, wholesale funding that reaches the MFBs could have a large impact on credit for micro and small enterprises that typically utilize MFBs for their credit needs.

It appears that the least effective (given the high set up and running costs) are state-owned banks. They tend to be highly complex institutions and given their limited branch network and accessibility, their ability to significantly increase access to credit for MSMEs is somewhat limited. In Nigeria, both the BOI and NERFUND have struggled to reach scale relative to the size of the MSME sector.

From the interviews conducted, there appeared to be a general view in the market that both MSMEs and financial institutions felt entitled to a piece of the 'national cake' (or that interventions by the Nigerian government were viewed as a means of redistributing national wealth rather than the provision of a credit support scheme that requires repayment). To ensure the success of public interventions, it is essential that both the CBN and the Nigerian Government educate the public that any loan or funding need to be repaid timeously.

Furthermore, typically a central bank's primary role is to manage money supply, promote stability and supervise and regulate the financial sector. In Nigeria, the CBN has expanded its role from a supervisory role to a developmental one – leading the design of public support initiatives such as credit guarantee schemes, agricultural policies and credit lines. However, there are risks associated with this approach, principally that (a) the CBN becomes overextended; and (b) financial institutions regard the CBN more as a disburser of credit and a go-to for funding to refinance their books during a time of crisis, than as a regulator.

The figure below presents an overall summary of the findings of this report.

Figure 11: Summary of Report Findings

Intervention	Recommended changes			
	Change	Detail	Organisation	Likely impact
General Environment				
• National Policy on MSMEs	-	Revise definition?	Federal Government of Nigeria, SMEDAN	Adjust banks' measurement parameters for interventions
• Microfinance Policy	↑	Enforce	Federal Government of Nigeria, CBN	Boost MSME credit access through MFBs
• Taxation laws	↑	Simplify	Federal Government of Nigeria, CBN	Lower burden on MSMEs
Enabling environment				
• ID system	↑	Implement	Federal Government of Nigeria	Lower risks associated with lending to MSMEs
• Credit bureaus	-	Maintain	CBN	Lower risks and costs associated with lending to MSMEs
• Registries	↑	Introduce/ reform	CBN	Lower costs associated with lending to MSMEs
Partial Credit Guarantees	↑	Review criteria	CBN	Improved utilisation
State banks and development finance institutions	↓	Maintain role as liquidity provider if needed	CBN, BOI and NERFUND	Reduced refinancing to the DMB
Apex and wholesale funding	-	Adjust to reach MFBs	CBN	Extend reach to the micro segment through the MFBs
Supply side capacity building	↑	Adjust to amplify scale	SMEDAN, RUFIN	Amplify impact
Encouraging innovation	↑	Monitor NIRSAL; Design MFB Development Fund	CBN/ Federal Government	Encourage new and innovative ways of lending to MSMEs

Scale	Increase funding/focus: ↑	Maintain funding/focus: -	Decrease funding/focus: ↓

Source: Genesis Analytics Team Analysis, 2012

Overall, it is therefore our recommendation that the Government focuses on strengthening and deepening the regulatory and enabling environment. It is our view that well-designed PCGs

EFInA
Enhancing Financial Innovation & Access

and supply side capacity building initiatives that can achieve scale may be the most effective drivers for increasing access to credit for MSMEs Nigeria.

9. KEY ISSUES REQUIRING FURTHER INVESTIGATION

Through the process of compiling this report, a number of issues have been flagged which have a potential impact on credit provision for MSMEs but which were impossible to investigate fully due to lack of data or were out of the scope of this report. As such, a short discussion of each has been included below to highlight the areas that would benefit from further investigation.

Most importantly it became clear during our process of evaluation that there is insufficient information available in the market to comprehensively assess the various public initiatives. As such we would recommend that an independent, authorized body conducts a full assessment of each initiative on behalf of the funders, ensuring that annual reports and financials are submitted wherever possible. This would help promote transparency and accountability in the market.

Furthermore, given that the success of interventions often rests on their ability to affect the banks' credit decision processes (through boosting revenue, or lowering cost or risk) further investigation into bank's perception of the MSME sector (as to whether they feel they are too costly, risky or yield too little profit) would be useful. This would reveal which of these three areas (revenue, cost, and risk) the interventions need to target to be most effective (notably this may vary across the micro, small and medium segments).

Data was not available for interventions which were recently launched so had not published any information at the time of undertaking this report, or because they had not yet been officially launched. SMEGCS is an example of the former, and has been in operation since 2010. While initial thoughts and impressions were that it has been successful in the market thus far, the CBN has not yet released its latest (2011) report, and therefore this impression could not be validated. NIRSAL is an example of the latter, and is currently in the final stages of design before its launch. Tracking the performance of these initiatives is critical, so as to be able to assess their effectiveness.

While the regulatory and enabling environments in Nigeria were not major focus areas for this report, it is evident that certain aspects of these categories are essential for an efficient financial market. The regulation and burden of taxation (sometimes multiple forms of taxation are imposed on MSMEs) is an aspect which negatively affects the market and was repeatedly raised by different stakeholders. Future research should investigate the costs associated with the current system. It can then be followed up with a study of international best practice in taxation, especially for MSMEs, with recommendations on possible improvements for the current system.

Finally, this report has suggested innovative means by which public entities can promote financial access i.e. Enterprise Challenge Funds and Social Impact Bonds. Research should focus on the feasibility of these initiatives in Nigeria, and the sectors/segments they should focus on.

APPENDIX

List of institutions interviewed by Genesis Analytics and EFInA representatives in Lagos and Abuja, January 2012:

1. Diamond Bank
2. First Bank of Nigeria
3. Lateral Links Limited
4. Doreo Partners Limited
5. Department for International Development (DFID)
6. Die Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ)
7. World Bank Micro, Small and Medium Enterprise (MSME) Project
8. Small and Medium Enterprises Development Agency of Nigeria (SMEDAN)
9. Rural Finance Institutions Building Programme (RUFIN)
10. Central Bank of Nigeria (CBN)
11. Bank of Industry (BOI)

Table 20: Cost Effectiveness of Schemes in Nigeria

Intervention	Cost/ Effectiveness of the scheme				Comment
General Regulatory Environment	Complexity	Capital/ funding required	Sustainability	Ability/ cost to achieve scale	
1. National Policy on micro, small and medium enterprises	◑	●	●	●	Although both these policies are fairly complex to design, once they have been designed and published they achieve scale in that they are disseminated to many stakeholders easily. They are sustainable as a well designed policy only requires revisions after a certain time period (usually between 5-10 years depending on market conditions). As regards funding, although policies typically require experts advice in designing, they cost very little.
2. Revised microfinance policy, regulatory and supervisory framework, 2011	◑	●	●	●	
4. Taxation laws	◔	◕	●	◕	Taxation laws are highly complex to design, and simplifying or adjusting tax laws is equally difficult. The cost of implementing is fairly low although there is some design and monitoring expense. Tax laws are however easily sustainable after they have been put in place as it simply requires monitoring and ensuring compliance.

Scale	Very complex/costly/unsustainable/unable to reach scale ○	Very simple/low-cost/sustainable/scaleable ●

Table 21: Cost Effectiveness of Schemes in Nigeria

Intervention	Cost/ Effectiveness of the scheme				Comment
Partial Credit Guarantees	Complexity	Capital/funding required	Sustainability	Ability/ cost to achieve scale	
1. SMECGS	◑	◑	◑	◑	SMECGS is relatively easy to manage (although managing the claims and evaluation process can add some complexity). Introducing appropriate fees may increase the sustainability of SMECGS. SMECGS' relatively large size will allow it to reach scale, although its focus on SMEs (rather than micro firms) could limit its impact on the MSME sector.
2. ACGSF	◑	◑	◔	◑	ACGSF is relatively easy to manage (although managing the claims and evaluation process can add some complexity). Introducing appropriate fees may increase the sustainability of ACGSF. The risks inherent in the agricultural sector may adversely affect the sustainability of ACGSF.
3. NIRSAL (pillar 1)	◑	◑	◑	◔	Although NIRSAL has not been launched yet it is clear that NIRSAL's pillar 1 is designed as a PCG which be relatively easy to manage although the design is complicated by balancing the various modalities in line with the operating environment in Nigeria. Similar to SMECGS and ACGSF, NIRSAL's pillar 1 will be sustainable if it can instil a lasting capability in agricultural lending.

Scale	Very complex/costly/unsustainable/unable to reach scale ○ Very simple/low-cost/sustainable/scaleable ●

Table 22: Cost/Effectiveness of Schemes in Nigeria

Intervention	Cost/ Effectiveness of the scheme				Comment
State banks and donor organisations	Complexity	Capital/funding required	Sustainability	Ability/ cost to achieve scale	
1. BOI	○	○	◔	◔	Operating an institution like the BOI is highly complex given it has both retail and wholesale lending. Although it is fairly expensive to run, it has achieved some success in terms of profitability over the recent years. The model is not completely sustainable in the long run however given that it relies on government funding. The fact that the BOI still only has 5 branches is indicative of its inability to achieve scale.
2. NERFUND	◑	◑	◔	◔	NERFUND is somewhat less complex to operate than BOI given that it offers fewer products and has a smaller balance sheet. Nonetheless implementing the lending scheme is fairly complex to do. Although NERFUND state they have achieved some profitability, the scheme still relies on funding from the government. The scheme does not appear to be sustainable as it serves only as a distributor of government funding (as such if this funding is retracted the scheme will collapse). Furthermore, NERFUND's fairly limited outreach indicates its inability to achieve scale.
Apex and wholesale funding					
1. NERFUND	◑	◔	◔	◔	NERFUND's wholesale funding is not comprehensively described on its website but it appears to be quite complex in that it offers loans to commercial institutions that would require monitoring. The fact that these are available in both local and foreign currency adds to this complexity. It is not currently clear what level of funding is required to finance these loans but it is assumed to be fairly large. Because any credit line will eventually be suspended the scheme is not highly sustainable.
2. N200bn manufacturing refinancing	◕	◔	◔	◑	This scheme is fairly simple to administer and manage given the modalities and eligibility criteria. The size of the scheme indicates that it is fairly costly (although it is likely that at the end of the scheme the majority of loans will be repaid the funding could have been invested elsewhere in the interim so one must also measure the opportunity cost). The scheme is not designed to be sustainable in the long run as after the loan terms have been reached, the fund will be terminated. The size of the fund and the rapid take-up by banks suggests that it has been fairly successful, although given the size of the SME manufacturing sector in Nigeria reaching scale will be a challenge.

Scale	Very complex/costly/unsustainable/unable to reach scale ○ Very simple/low-cost/sustainable/scaleable ●

Table 23: Cost/Effectiveness of Schemes in Nigeria

Intervention	Cost/ Effectiveness of the scheme				Comment
Supply side capacity building	Complexity	Capital/funding required	Sustainability	Ability/ cost to achieve scale	
1. NIRSAL (pillar 3)	◑	◕	◔	◔	Designing a technical assistance facility like NIRSAL's pillar 3 is fairly standard in its process. Not that much capital or funding is required – other than the staff trainers typically. For the scheme to be sustainable, the skills transfer must be long lasting but typically the training will be need to be continuous given employee attrition and the fading of knowledge. Thus funding may need to be continuously disbursed. Such programs typically struggle to reach scale however given the training has limited outreach.
2. SMEDAN	◑	◕	◔	◔	SMEDAN's capacity building program is fairly standard in its process of delivery. A fairly low amount of funding is required to sustain the scheme. For the scheme to be sustainable, the skills transfer must be long lasting but typically the training will be need to be continuous given employee attrition and the fading of knowledge. Thus funding may need to be continuously disbursed. The scheme has achieved limited scale to date.
3. RUFIN	◑	◕	◔	◔	RUFIN's capacity building is fairly standard in its delivery. To date a fairly low amount of funding has been rolled out for the scheme. For the scheme to be sustainable, the skills transfer must be long lasting but typically the training will be need to be continuous given employee attrition and the fading of knowledge. Thus funding may need to be continuously disbursed. The scheme has achieved limited scale to date.
Enabling environment					
1. ID	◔	◔	●	●	Designing a system to capture an entire population's details is fairly complex and requires a large amount of funding (paying home affairs staff etc). The system is highly sustainable once it has become the norm and will achieve scale given it is a national scheme.
2. Credit bureaus & collateral registries	◑	○	●	◑	Credit bureaus and registries are complex institutions that rely on well trained staff and systems. They are not costly given that they are private institutions. Once the system has been properly implemented and banks are regularly submitting info the system is sustainable. Scale can be reached if stakeholders remain committed.
Innovation funds					
1. NIRSAL (pillars 2, 4 & 5)	◕	◑	◔	◑	Innovation funds such as NIRSAL's are not very complex to administer and design. They do however require a fairly high amount of funding given they are grants. They have the chance to be sustainable if they generate new and efficient innovations but this is not guaranteed. Their ability to achieve scale depends on whether the innovations produced are scalable.

Scale	Very complex/costly/unsustainable/unable to reach scale ○	Very simple/low-cost/sustainable/scaleable ●

BIBLIOGRAPHY

Abereijo, I. and Fayomi A., 2005. *Innovative approach to SME financing in Nigeria: A review of SMIEIS,* Nigeria. http://www.krepublishers.com/02-Journals/JSS/JSS-11-0-000-000-2005-Web/JSS-11-3-173-258-2005-Abst-PDF/JSS-11-3-219-227-2005-265-Abereijo-I-O/JSS-11-3-219-227-2005-265-Abereijo-I-O-Full-Text.pdf, Accessed: 23 February 2012.

Agricultural Credit Guarantee Scheme Fund, 2009, *2009 Annual Report,* brochure

All Africa, *Nigeria: Leasing Industry records N1.8 Trillion Transactions in 5 years*, 2011. http://allafrica.com/stories/201106130607.html, Accessed: 19 Feb 2012.

Bank of Ghana, 2011. 'Collateral Registry – All you Need to Know', http://www.bog.gov.gh/index.php/about-the-bank/collateral-registry, Accessed: 19 February 2012.

Bank of Industry, 2010, *Transforming Nigeria's Economy, 2010 annual report & accounts,* brochure

Beck, T. Klapper, J. Mendoza, C. 2008. *The Typology of Partial Credit Guarantee Funds Around the World,* World Bank. Washington DC.

Benavente, José Miguel, Alexander Galetovic, and Ricardo Sanhueza, 2006, *Fogape: An economic analysis*, Working Paper 222 University of Chile Santiago, Chile

Central Bank of Nigeria, undated (a), *SMEEIS Guidelines*
http://www.cenbank.org/OUT/PUBLICATIONS/GUIDELINES/DFD/2006/REVISED%20SMEEIS%20GUIDELINES.PDFAccessed: 24 Feb 2012.

Central Bank of Nigeria, undated (b), *N200billion Small and Medium Enterprises (SME) Credit Guarantee Scheme (SMECGS),*
http://www.cenbank.org/Out/2010/publications/guidelines/dfd/GUIDELINES%20ON%20N200%20BILLION%20SME%20CREDIT%20GUARANTEE.pdf, Accessed: 27 February 2012

Central Bank of Nigeria, undated (c), *Guidelines for the Agricultural Credit Guarantee Scheme Fund* http://www.cenbank.org/devfin/acgsf.asp, Accessed: 16 February 2012.

Central Bank of Nigeria, undated (d), *Guidelines for the Interest Drawback Programme*, http://www.cenbank.org/out/Publications/guidelines/dfd/acgsfidpguideline.pdf, Accessed: 19 February 2012

Central Bank of Nigeria and the Federal Ministry of Agriculture and Rural Development undated (e), *Guidelines for CACS,* http://www.cenbank.org/Out/2010/publications/guidelines/dfd/CACS_%20GUIDELINES_OCT_2010.pdf, Accessed: 19 Feb 2012.

Central Bank of Nigeria undated (f), *NIRSAL, Nigeria Incentive-based risk-sharing system for agricultural lending*, brochure

Central Bank of Nigeria, 2006, *Guidelines for the operation of the Agricultural Credit Support Scheme (ACSS),* http://www.cenbank.org/OUT/PUBLICATIONS/GUIDELINES/DFD/2006/ACSSGUIDELINES.PDF

Central Bank of Nigeria, 2011, *Banks in Nigeria and national economic development: a critical review*, *Speech by CBN governor* http://www.cenbank.org/out/speeches/2011/Gov_Banks%20in%20Nigeria%20and%20National%20Economic%20Development_CHC-CIBN-RBC_040611.pdf, Accessed: 23 Feb 2012.

Central Bank of Nigeria. 2012a, 'Bank Supervision', http://www.cenbank.org/Supervision/, Accessed: February 18 2012.

Central Bank of Nigeria. 2012b, 'Statistical Bulletin', http://www.cenbank.org/documents/Statbulletin.asp, Accessed: February 22 2012.

Central Bank of Nigeria, 2012c, *Activities of the N200 billion Commercial Agriculture Credit Scheme (CACS) for the month of March 2012,* http://www.cenbank.org/OUT/2012/PUBLICATIONS/REPORTS/DFD/CACS%20REPORT%20FOR%20MARCH%202012%20.PDF, Accessed: May 16 2012.

Central Bank of Nigeria, 2012d, *Agricultural Credit Guarantee Scheme Fund (ACGSF) Cumulative Report, January – December 2011* http://www.cenbank.org/out/2012/publications/guidelines/dfd/acgsf%20statistics%20jan-dec.pdf, Accessed May 16 2012.

Compuscan, 2010. 'Uganda recognized globally for improvements in ease of getting credit', http://www.compuscan.co.za/press-room/110-uganda-recognized-globally-for-improvements-in-ease-of-getting-credit, Accessed: 9 February 2012.

De la Torre, Augusto, Juan Carlos Gozzi, and Sergio Schmukler. 2007. *Innovative experiences in Access to Finance: Market Friendly Roles for the Visible Hand,* Policy Research Working Paper No 4326. August. The World Bank. Washington DC

Duflos, E., Mayada, E. 2010. *Apexes: An Important Source of Local Funding,* CGAP Washington DC.

Economic Confidential, 2011, *Interview with NERFUND CEO April 2011* http://economicconfidential.net/new/interviews/665-how-nerfund-provides-loans-for-micro-and-smes-in-nigeria, Accessed: 23 Feb 2012

EFInA, 2010a, *Financial Services Landscape in Nigeria September 2010 (Full Report)*, Oxford Policy Management Group & Development Associates

EFInA, 2010b, *EFInA Access to Financial Services in Nigeria 2010 Survey*

Federal Republic of Nigeria, (undated) brochure, *National Policy on Micro, Small and Medium Enterprises*

Federal Republic of Nigeria & CBN, 2011, brochure, *Revised Microfinance Policy, Regulatory and Supervisory Framework for Nigeria*

First Bank Nigeria, 2010. *Annual Report 2010*, http://firstbanknigeria.com/Portals/2/pdf/Reports/Annual%20reports2010/FirstBank-ARA-Dec-2010.pdf, Accessed: 21 Feb 2012.

Global Partnership for Financial Inclusion and IFC, 2010. *Scaling Up Access to Finance for Agricultural SMEs Policy Review and Recommendations*. GPFI and IFC, Washington DC

Global Partnership for Financial Inclusion. 2011, 'Global Standard Setting Bodies and Financial Inclusion – Insights and lessons from five countries: Brazil, Kenya, Mexico, the Philippines and South Africa', GPFI.

Gordhan, Pravin, Minister of Finance South Africa, *Budget Speech,* 2012, http://www.treasury.gov.za/documents/national%20budget/2012/speech/speech.pdf, Accessed: 24 Feb 2012

IFC, 2002, *IFC donor supported technical assistance program,* Washington DC

IFC, 2010, Advisory Services – Access to Finance. *The SME Banking Knowledge Guide*, IFC, Washington DC.

IFC, 2011a, SME Conference, *IFC Africa SME Banking Conference 2011,* IFC, Johannesburg.

IFC. 2011b, ' G20 SME Finance Consultation – Phase III Online Consultation: Public Policy & Interventions', http://www.ifc.org/ifcext/g20ifcsmeconslultation.nsf/Content/Publication13, Accessed: January 28 2012.

Isaac, Nkechi, 2012, *Nigeria: Napep poised to disburse N1.2 billion*, All Africa news article, http://allafrica.com/stories/201202210344.html, Accessed: 7 March 2012.

Isern, J., Agbakoba, A., Flaming, M., Pellegrini, G. and Tarazi, M. 2009, *Access to Finance in Nigeria: Microfinance, Branchless Banking and SME Finance,* CGAP, Washington DC.

Logbaby, 2012, *Govt releases agricultural transformation agenda,* http://www.logbaby.com/govt-releases-agricultural-transformation-agenda-9031.html, Accessed: 7 March 2012.

Mambula, C. 2002, *Perceptions of SME Growth Constraints in Nigeria*, Journal of Small Business Management, Volume 40(1), pp. 58 – 65.

Microfinance Africa, 2011, *Revised Policy fails to excite MFB operators,* 2011, http://microfinanceafrica.net/tag/nigeria-microfinance-policy-framework/, Accessed: 19 Feb 2012.

Obadan, undated, *Poverty Reduction in Nigeria, the way forward*, CBN Economic and Financial Review, vol.39, No.4.

OANDA. 2012, 'Currency Converter', http://www.oanda.com/currency/converter/, Accessed: February 20, 2012.

OECD, 2004, *Promoting Entrepreneurship and innovative SMEs in a Global Economy, proceedings of the 2nd OECD Conference of Ministers Responsible for Small and Medium-Sized Enterprises (SMEs)*

Opara, S. 2011. *Maximising leasing finance options for SME growth*, 2011. http://www.nigerianbestforum.com/generaltopics/?p=91284, Accessed: 19 Feb 2012.

Oyeralan-Oyeyinka, Banji, *Presentation at the Financial System Strategy 2020 International Conference titled SME: Issues, Challenges and Prospects, http://www.cenbank.org/fss/wed/SME_Issues,%20Challenges%20and%20Prospects_Oyeyinka%20Banji.pdf, Accessed: 23 Feb 2012.*

Pitigala et al, 2011. *Impact of Multiple Taxation on Competitiveness in Nigeria*, 2011. http://siteresources.worldbank.org/INTAFRREGTOPTRADE/Resources/16_The_Impact_of_MultipleTaxation_on_Competitiveness_in_Nigeria.pdf, Accessed: 19 Feb 2012.

Proshare Intelligence Investing, 2012, *Diamond Bank disburses N30b to MSMEs* http://www.proshareng.com/news/16289, Accessed: 5 March 2012

Punch, 2012. *Reps summon ex-presidential aide over N20bn NAPEP Funds*. http://www.punchng.com/news/reps-summon-ex-presidential-aide-over-n20bn-napep-funds/, Accessed: 19 April 2012

Reille, X., Helms, B. 2004*, Occasional Paper, Interest Rate Ceiling and Micro-finance: The Story so far'*, GCAP, Washington DC

Rocha, R., Y. Saadani, Zs. Arvai. 2010. *Assessing Credit Guarantee Schemes in the Middle East and North Africa Region*. World Bank. Washington DC.

Rudolph. Heinz. 2010. *State Financial Institutions: Can they be relied on to kick start lending?* Crisis Response: Public Policy for Private Sector. Note Number 12. FPD. The World Bank, Washington DC.

RUFIN undated, *FGN/IFAD Assisted Rural Finance Institution Building Program*, Brochure

SMEDAN, *2011 Annual Report*, hard copy distributed by SMEDAN.

Social Finance, 2011a. 'Social Impact Bonds', http://www.socialfinance.org.uk/sib, Accessed: 23 February 2012

Social Finance, 2011b. 'Social Impact Bonds – One Year on', http://www.socialfinance.org.uk/resources/social-finance/social-impact-bonds-one-service-one-year, Accessed: 23 February 2012

Terungwa, Azende, 2011. *An empirical evaluation of small and medium enterprise equity investment scheme in Nigeria*, Benue Stat University

The Reserve Bank of India. 2007, 'Lending to Priority Sector', rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/73748.pdf, Accessed: 15 February 2012.

World Bank, 2008. *Finance for all? Policies and Pitfalls in Expanding Access,* The World Bank, Washington DC.

World Bank, 2009, *Making Finance Work for Nigeria,* http://siteresources.worldbank.org/INTAFRSUMAFTPS/Resources/Making_Finance_Work_for_Nigeria.pdf. Accessed: 7 March 2012.

World Bank, 2011a. *Financing of Small and Medium Enterprises in the Republic of South Africa,* The World Bank, Washington DC.

World Bank, 2011b, *MSME Taxation and State Building presentation* http://www.imf.org/external/np/seminars/eng/2011/revenue/pdf/awasthi.pdf, Accessed: 19 Feb 2012

World Bank. 2012, *Nigeria SME Finance 2011 – 2012 Survey Results & Conclusion,* The World Bank, Washington DC.